International Labour Organization

VILLAGE BANKING IN LAO PDR

Handbook for Village Bank Management Committees and Support Organizations

Subregional Office for East Asia

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Village Bank Management Committees and
Support Organizations

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ACRONYMS

FINCA	Fundación Integral Campesina
ILO	International Labour Organization[1]
LCSDPA	Lao Community Sustainable Development Promotion Association[2]
MFI	Microfinance institution
NGO	Non-governmental Organization
PAR	Portfolio at Risk
RDMA	Lao-German Programme on Integrated Rural Development in Mountainous Areas of Northern Lao PDR
PDR (in Lao PDR)	People's Democratic Republic

CURRENCY EQUIVALENT

10,000 Lao Kip = 1 USD

[1] The International Labour Organization (ILO) is a specialized agency of the United Nations dealing with labour and employment issues. In Lao PDR and elsewhere, the ILO tries to ensure that women and men have access to jobs, and that in these jobs their human and workers rights and need for a decent income are respected.

[2] The Lao Community Sustainable Development Promotion Association (LCSDPA) is a registered non-profit organization operating a village banking programme in Lao PDR. It aims to alleviate poverty by supporting communities in the rural and remote areas of Lao PDR to create sustainable village banks. Since the start of its activities in 2005, it has helped to create over 100 village banks in Khammouane, Savannakhet and Champasack provinces.

INTRODUCTION

Village banking offers a way of giving poor women and men in rural and often remote areas access to much needed financial services.

Through village banks, members of low-income communities can save or obtain loans to help set up or improve their businesses, invest in long term life needs such as health or education, or to deal with emergencies. In areas where there is a high level of out-migration and a high incidence of human trafficking, the enhancement of opportunities at home decreases the pressure to migrate, and the scope for trafficking.

Unlike some other microfinance models, where the users are only on the receiving end of services provided by outsiders, village banks are owned and run by the members. Because of this, apart from better access to finance, village bank membership and participation in its management is also an empowering process which gives those who are involved more control over their own lives as well as more say in the community. This is especially important for the poorest members of the community, and for others who are often left outside the traditional village power structures, such as women.

While they are set up by their members, support organizations, such as NGOs or microfinance institutions (MFIs) often act as a catalyst helping village banks to emerge. To guarantee the sustainability and success of the village bank's operations, different types of support services – for instance the provision of technical assistance or auditing – are also needed after the initial setting up phase.

The main objective of this handbook is to help improve management capacity at the village level and contribute to the strengthening of provision of support to village banks. As such, it is primarily designed for use by support organizations and village bank management committees.

This handbook is based on the village banking methodology which ILO, together with the Lao Community Sustainable Development Promotion Association (LCSDPA), has implemented in Champasack, Khammouane and Savannakhet provinces of Lao PDR as part of its endeavour to enhance income generating opportunities and to combat trafficking in women and children.

The handbook consists of three parts. Part I explains what village banking is about, how village banks work and what principles help to ensure their success. Part II on the operation of village banks covers savings and loan policies, management, rules and regulations, gender equality as well as accounting. Part III focuses on the role of support organizations.

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PART 1
WHAT IS VILLAGE BANKING?



CHAPTER 1. BASICS OF VILLAGE BANKING

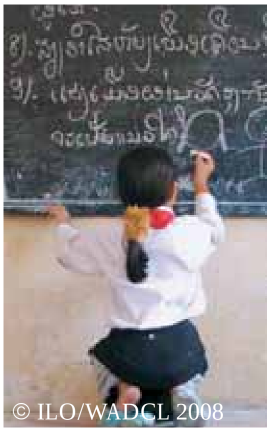
Why are village banks needed?

All people need financial services, and poor people often have a more urgent need for them than rich people.

In poor communities, income flows are small and often unpredictable, and having access to other funds – savings or a loan – can make the difference between poverty and a decent quality of life.

People's financial needs are different but they will be likely to fall under one of the following:

- **Business needs or income generation needs**: For new businesses, the profits at the beginning may not be high enough to cover all the costs that arise from setting up a new business, such as purchasing new equipment. Having access to additional cash is also important for existing businesses which can increase their profits through improvements made with a loan.



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Life needs: People will also need to spend on services, activities or goods which improve:

- their quality of life and secure a better future. Larger sums of money are usually needed to cover the cost of education or health services, for example.

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- **Emergencies**: Coping with the sudden illness or death of a family member, a crop failure, or the destruction of housing through a fire and other unexpected events usually requires large amounts of money. In such situations, being able to access extra money can enable people to continue with their lives and avoid falling into deeper poverty.

Getting this extra money is not always easy. Most poor people will do so by trying to save some of the income they earn, or by borrowing.

Without a village bank, options for saving and borrowing can be limited:

- **Formal banks** do not usually have branches in remote areas, and using a bank located far away is expensive and time-consuming. The complicated formalities that are needed for opening an account or obtaining a loan can also be an obstacle for people with a low level of education or little experience in dealing with formal institutions. Many banks do not accept poor women and men as clients because they do not have guarantees, or because the loans or amounts of savings are too small.

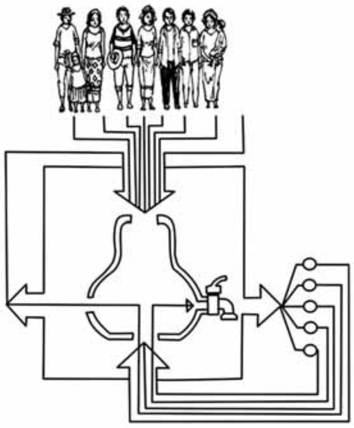
- Since most poor people cannot use formal banks, they mostly **save in kind**, for instance by buying livestock. In-kind savings cannot always be quickly and easily converted into cash, however. In many cases savings are also **kept at home**, which is risky since the money can get destroyed, stolen, or used up carelessly. Apart from the help of family and friends, most people will rely on informal **money-lenders** for loans. This is expensive because of high interest and/ or fees, however. Another problem is reliability.

How does village banking[3] work?

Village banks are a better alternative. They offer savings and credit services to the village residents, who jointly establish, own and run the bank. Through village banks, poor people can save and obtain loans on their own terms and without leaving their village.

The mechanism is simple:

- The members determine their **own by-laws** and elect a **management committee** from among themselves. The committee distributes loans to individuals, keep savings, collects payments and keeps records.
- When the members **deposit savings** in the village bank, money is accumulated which can be used for lending to other members or put in a commercial bank account for interest.



- When members **take out loans**, they pay interest on them which helps to cover the costs of the village bank and help it to grow.
- At the end of each year, the members **receive interest** on their savings. The interest is paid from the surplus of the village bank, and the share that is given to each member is based on their savings record during the year. This means that the surplus stays in the village. It also means that all of the village bank members will be likely to strive for a good savings performance, and to make sure that the village bank operates well, since they will only receive interest if the village bank makes surplus.

The role of support organizations

NGOs or microfinance institutions often help village banks to emerge:

- The main role of such support organizations at the start is to **raise awareness** on the concept of village banking and **provide training**.

[3] The concept of "Village Banking" is often associated with the model developed by FINCA, an international NGO. The methodology used by the ILO which is referred to in this handbook has been adapted to suit the context in Lao PDR, and differs from the original FINCA model in several respects, the most significant of which is that ILO-supported village banks are savings-based, and in contrast to the FINCA model, do not systematically receive external loans but operate through the funds accumulated from the members' savings.

- In some cases, support organizations **may provide a loan** to the village bank to help it get started. The loan is repaid by the village bank at the end of an agreed period. Further loans are not necessarily needed. Instead, the members' savings and the interest on loans given out provide the capital needed for the village bank to work.
- Once the bank has been established, the support organization continues to **provide technical assistance** as needed, for example through auditing, against a small fee.

The government also has a role to play. Government departments do not usually have the technical expertise to be able to provide services to the village banks in the same way that specialized organizations do. However, the government can help village banks through **a favourable policy environment and appropriate regulations**.

Support organizations and the government can provide:
- technical support in setting up and running the bank
- loans to the village banks for initial loan funds
- a favourable policy and regulatory environment

…but the members of the village bank:
- manage the bank and do financial administration
- decide on their own savings and loan policies
- supply the bulk of loan funds with their savings

See Part III of this handbook for more on the role of support organizations.

CHAPTER 2. KEY PRINCIPLES FOR SUCCESS IN VILLAGE BANKING

Experience shows that some key principles help village banks work well. Village banks should ideally be:

1. Savings-based. Village banks can fail more easily when funding does not come from the members' contributions, but from an external source, for example a grant from an NGO.

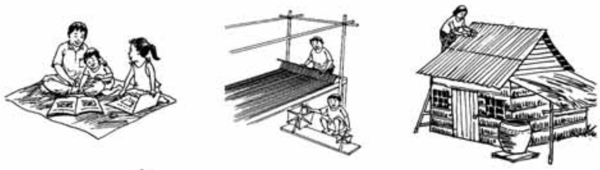
If the money that is lent out comes from the members themselves, they will use it more carefully since their own savings are at stake.

Loans will mostly be used for an investment that will bring long term gains (e.g. education, health or business costs) or to help in the case of an emergency (e.g. crop failure).

If the money comes from outside, those who receive loans may consider it "free money", and they may not be careful with their loan use.

In such cases the money is often wasted on unnecessary non-productive purposes.

When the members' own savings are used to fund loans, it almost always guarantees responsible loan use.



When the money for loans comes from outside, it often leads to irresponsible loan use.

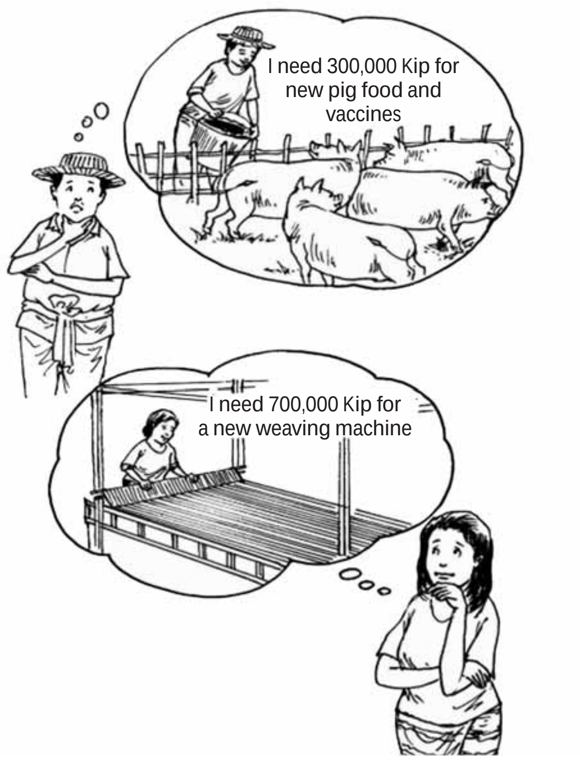
2. Inclusive & democratic. There is a risk that richer or more powerful individuals in a community may influence the village bank, or be able to benefit more from it than others. To avoid this:

- Committees should be elected through regular democratic elections by ballot.
- Decisions on important issues, such as interest rates or maximum loan size, should be made with the agreement of the majority of the members. These decisions should be adopted according to a set procedure (e.g. only at a general meeting where at least 50% of the members are present and with a minimum of 2/3 of votes in favour) as outlined in the internal regulations. Once adopted, the decisions should be incorporated in the village bank's general rules (see Chapter 6) or made public in a separate document.

- The ability of disadvantaged groups or individuals – such as widowed women or the poorest members of the community – to participate in and benefit from the village bank should be guaranteed.

3. Client/Needs-focused. The policies of the village bank should be based on the needs of its members. Their financial needs may not always be identical:

- Some families may need larger loans than others, or the amount of time for which a loan is needed may be different. Some members may also be able to save more per month than others.
- These different member needs should be taken into account when loan and savings policies are decided on. Making sure that members are happy and satisfied with the services of the bank means that they will continue to use it and keep it running.



4. Well-managed. The village bank should aim to: 1) avoid possible abuses, 2) make sure that members have equal chances to benefit and 3) guarantee the bank's financial sustainability (i.e. its ability to operate without external funding).

Ways which help to achieve this include making sure that:

- There is transparency: records should be kept carefully and be accessible to members, and decision-making should be participatory and done according to previously agreed procedures
- There are limits on maximum loan size and loan term
- Measures are in place to ensure compliance with village bank regulations and prevent non-repayment or late payments

PART 2
THE OPERATION OF THE VILLAGE BANK

CHAPTER 3. SAVINGS AND LOAN POLICIES

Savings policies

Village bank members can deposit their savings in the village bank.

This is a more convenient and easy to access option than many other ways of storing savings (such as in formal banks). When the village bank is well-managed, the members' savings are kept safe, and they receive interest on them.

Savings can usually be deposited at regular intervals (for example, weekly or monthly, depending on the village bank's policies). In most village banks, each member can decide how much he/she wants to deposit, and save different amounts each month according to his or her financial situation. While members can also withdraw savings on set days each month if needed, the way savings interest is calculated (see Chapter 8) encourages them to keep their savings in the village bank.

These savings help the saver to build up a large sum over time which can be used for different life or business needs.

Some key issues linked to savings policies are discussed below.

What should be done with the savings in the village bank?

Once members have deposited their savings in the village bank, the village banks usually choose one of the two options below, or a combination of both:

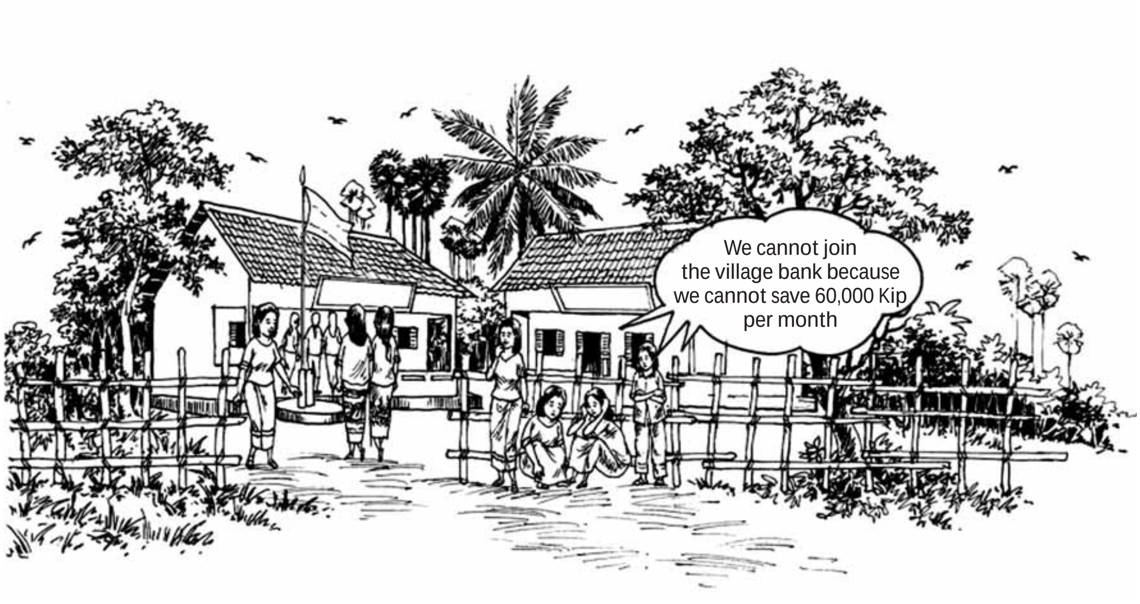
- Most village banks **use the savings as loan funds** to issue loans to village bank members. Those who receive these loans pay interest on them, which increases the village bank's income.
- Some village banks may choose to put the collective savings in a **formal bank**. When the savings are deposited in a formal bank, interest is paid on them, and this goes back into the village bank's fund.

In most cases, formal banks are used only when there is not enough demand for loans from the village bank members, and there is an excess of funds in the bank. The demand for loans may vary according to the season or other factors affecting the members' spending needs.

Savings duties

In contrast to some microfinance models, in ILO-supported village banks there are no "compulsory savings", i.e. savings that must be deposited in set amounts or at set intervals by the members. Instead, the members make deposits voluntarily in the amounts and at intervals which they chose.

Village banks should refrain from introducing compulsory savings requirements, since these mean that the individual members' needs or capacity to save are not taken into account, and certain groups, such as the poorest members of the community, may not be able to use the bank.



However, as a means of preventing repayment problems, when issuing loans, it is recommended that village banks require members to deposit a certain amount of savings before they can apply for loans. In ILO village banks, the loan size cannot exceed five times the amount of savings deposited by the loan applicant.

Distribution of village bank surplus and interest on savings

At the end of the year, the yearly surplus of the village bank is divided up for different purposes:

- The largest share of the surplus – usually around 70% – is **distributed to the savers as interest**. Each member gets an amount which is based on how much they have saved (see Chapter 8), so those who save more also get more.
- Some of the surplus needs to be set aside for the **payment of the management and advisory committees**. Many village banks initially allocate 15% for the management committee fees. When the village bank grows, this percentage may lead to a disproportionately high payment which does not correspond to the time and labour taken up by the management committee work. In such cases, the village bank may choose to reduce the percentage of the surplus that is given to the management committee, or to retain the percentage but impose a cap, e.g. no more than 3 million Kip. The same applies to the advisory committee.
- Some is kept in the fund as **capital**. If the percentage set aside for this purpose is low at beginning, once the village bank grows, it may wish to increase the percentage in order to build its capital.
- Apart from these purposes, some villages use part of the money for the **development of the village** or **welfare capital**.
- For the village banks that it supports, the ILO recommends that some of the surplus (2%) is set aside to pay for the **services of support organizations**. As with the other items above, the percentage used for these services may need adjustment depending on the amount of surplus generated and the costs incurred by the support organization.

Some village banks may prefer to keep all of the money in the village and may not initially want to pay for support services. However, some of these services are important for the village bank. For example, most village banks will not have the skills to carry out auditing. Even when they have the skills, it is better that an external auditor performs at least part of the auditing work. This is why the cost of auditing should be kept in mind when village banks decide on what to do with their surplus.

Surplus of the village bank	
Interest for members	70%
Payment of management committee	15%
Payment of advisory committee	5%
Capital	3%
Village development capital	2.5%
Welfare capital	2.5%
Auditing costs	2%

See Part III of the handbook for more on auditing and the role of support organizations.

Loan Policies

In addition to savings services, village banks offer credit services to their members. Loans can be taken out for business purposes, to meet needs which cannot be financed in other ways, or to cope with emergencies.

Requests for loans are considered by the management committee, which disburses loans at set times (e.g. once a month). The rules related to the terms and conditions of getting a loan, such as the guarantees needed or the amount of interest that will be paid, are decided in advance by the village bank members. The loans (both the amount borrowed and interest on it) are then paid back to the village bank, either in instalments, or in one go at an agreed time. One advantage of instalments is that it is easier for the borrower to manage repayment. Repayment by instalments is also beneficial for the village bank because it is able to issue new loans with the money that it receives through the instalments, rather than having to wait until the end of the loan term.

The village bank members need to decide on policies which relate to loans. Key issues are discussed below.

Key issue 1: Loan size & term

Loan size

Issuing many small loans is more work for the village bank than issuing a few large loans because the amount of administrative work involved in each loan.

However, issuing very large loans is problematic:

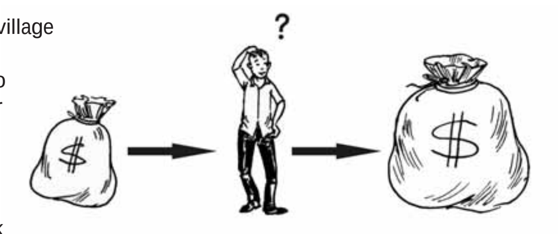
- Since village banks serve mostly poor people, and since poor people do not necessarily need or want very large loans, issuing small loans – which most members can not get from formal banks – is one of the main reasons why village banks exist.

Small loans:

- Are more time-consuming for the village bank to manage than large loans
- May sometimes not be sufficient to reach the results that the borrower hopes to get

But they are:

- Needed by the poor
- Easier for the borrower to pay back
- Less risky for the village bank



With big loans:

- The borrower might be able to do more
- There is less processing work

But they are:

- There is a risk that the loan cannot be paid back
- There is a risk that only rich people will benefit

- Large loans can be more difficult to pay back for the borrower.
- When borrowers fail to pay back large loans, the loss is larger for the village bank than in the case of a small loan.

For these reasons, village banks should set a limit on maximum loan size. Most of the village banks supported by the ILO have maximum loan limits between 2-3 million Kip. There should also be a limit on the share of the portfolio loaned out to a single member: a single loan should not represent over 10% of the total portfolio.

Rather than giving out large loans from the start, a more prudent strategy for the village bank is to renew loans based on repayment records. In this case the size of loans can be gradually increased. Prudent and gradual increases in the loan size will support the growth of the village bank in the long run.

Loan term

The loan term is the length of time for which a loan is given before it needs to be paid back.

In the same way that a large loan is more risky than a small one, a long loan term implies a higher risk than a short one. It is also more costly for the borrower, because more interest payments have to be made.

However, short loan terms may not suit the needs of the users. While some members may need loans for only short amount of time, and are able to repay immediately, sometimes the purpose of a loan can only be achieved after a longer period of time:

- For example, a business loan taken out for the purpose of being able to buy goods which are resold almost immediately will fulfil its purpose quickly.
- On the other hand, a business loan taken out for agricultural purposes (e.g. for animal raising), will require more time to have an effect. In this case a longer loan term may be a better option.

In ILO-supported village banks, loan terms usually range between 4-6 months. Generally, the loan term should be based on the members' needs. If these needs are not taken into account, the result will not just be dissatisfaction among the members. It may prevent the members from paying back their loans and increase the default rate (the default rate refers to the amount of loans that are not paid back).

Key issue 2: Collateral

“Collateral” refers to assets that are pledged to guarantee the repayment of a loan.

As a condition to obtain loans, formal banks often require guarantees that poor people do not have. This may include assets such as land or property. Village banks, on the other hand, accept collateral that poor people can and usually do have access to, such as:

- Household appliances, small livestock or personal items like jewelry.
- Personal guarantors who will pay the loan in case the loan taker fails to do so.

Some forms of collateral are more risky for the borrower to pledge than others:

- For instance, some luxury items such as jewelry or a television may have high monetary value if sold. However, the loss of such items will not have an impact on the ability of their owners to sustain themselves or their families.
- This is not the case of items which are linked to their livelihoods. Losing livestock or business assets can jeopardize food security or the ability to continue earning an income.

Key issue 3: Interest rates

When village bank members take out loans, they have to pay back both the amount borrowed and interest.

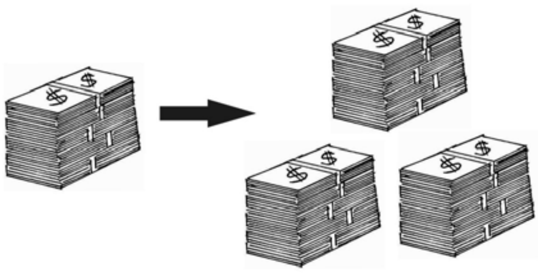
The interest is the amount that is paid to the village bank for using the loan money.

❖ How high should interest rates be and how are payments calculated?

The interest rates are decided on by the village bank. When deciding on interest rates, several factors should be taken into account:

If interest rates are **too low**:

- The village bank will not be able to cover costs, such as the payment of the management committee or auditing. If it has a loan from an external source, it may also not be able to pay back that loan or the interest on it.
- Loan losses in case of unpaid loans are not covered.
- The fund will not grow. When members pay interest on loans, it increases the income of the village bank, but the bank will only grow if the income from interest is higher than the costs that must be covered with it.

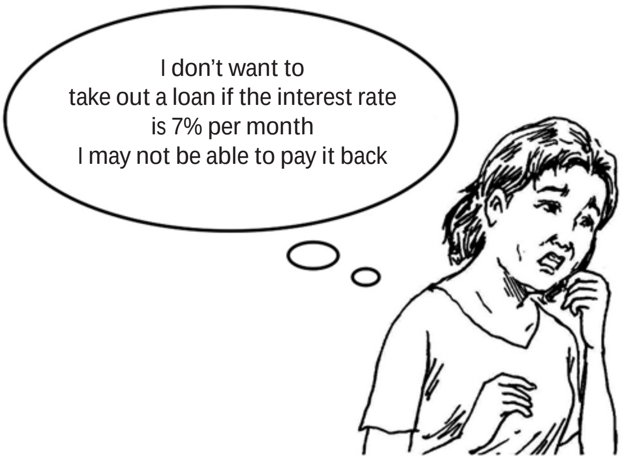


The interest paid on loans increases the income of the village bank and means more surplus for the bank and its members.

- Savings interest, which is based on the surplus that the village bank makes through loan interest, will be low. This means that people's willingness to save with the bank may decrease.

However, if interest rates are **too high**:

- The demand for loans may go down. If the members think that the interest rate is too high, they may not want to take out loans.
- Some members may find it difficult to pay back their loans, and the default rate may rise.
- Very high interest rates may mean that the poorest members of the community will not be able to take out loans, since only richer members will be able to afford them.



These factors should therefore be thought about when setting the interest rate. In ILO-supported village banks, interest rates on business loans are generally between 3-5% per month. Interest rates for emergency loans are usually lower (these loans are discussed in Key issue 4 below). The interest payments are calculated using the "declining balance" method. This means that interest is only paid on the amount of loan capital that has not yet been paid back, and therefore decreases with each instalment (see example in Box 3.1).

Box 3.1. Mr. Bounpone's interest payments

Mr. Bounpone took out a loan of 3,000,000 Kip on 1/1/2008. The loan term is 6 months and the interest rate is 3% per month. He pays the loan back in 3 instalments and makes monthly interest payments until the loan has been paid back. Interest is only paid on the amount of loan capital that is still outstanding. Therefore, each time when he pays back some of the loan capital, the amount of interest to be paid decreases. As shown in the table, at the beginning, he pays 3% interest on the total loan amount of 3,000,000 Kip, which amounts to 90,000 Kip. After he pays his first instalment on 1/3/08, the outstanding balance decreases to 2,000,000 Kip, and the next interest payment is 3% of that amount, or 60,000 Kip. Similarly, after he pays his second instalment, his outstanding balance becomes 1,000,000 Kip, and the interest decreases to 30,000 Kip.

Date	Loan disbursement	Repayment of loan capital	Interest payment (3% per month)	Outstanding balance
1/1/08	3,000,000			3,000,000
1/2/08			90,000	3,000,000
1/3/08		1,000,000	90,000	2,000,000
1/4/08			60,000	2,000,000
1/5/08		1,000,000	60,000	1,000,000
1/6/08			30,000	1,000,000
1/7/08		1,000,000	30,000	0

❖ The effect of inflation on the interest rate

Inflation refers to a rise in the general level of prices in a country. This means that fewer goods can be bought for the same amount of money as before inflation, and the cost of living rises. For example, if the inflation rate is 2% per year, then the price of a food item which cost $1 at the beginning of the year would cost $1.02 at the end of the year.

Since inflation lowers the value of money, it also lowers the income of the village bank:

Interest rate charged by the village bank – rate of inflation = real interest rate colleted

In 2000, Lao PDR had an inflation rate of 27% per year. In such a case, if a village bank were to charge 2% per month on its loans, the yearly interest rate of 24% would actually be lower than the rate of inflation. This means that the real interest rate collected would be negative, since 24% (interest rate charged by the village bank) – 27% (rate of inflation) = -3%.

For the village bank to actually be paid for lending out money, the real interest rate must be positive. Therefore, it is important that village banks check that the interest rates they charge are higher than the expected rate of inflation.

Key issue 4: Emergency loans

Most loans given out by village banks are for business purposes.

In addition, when members are faced with **emergency situations**, such as a sudden illness or death in the family, or destruction of housing or business assets, many village banks also give out emergency loans.

Emergency loans need to be:

- **Affordable**. Emergency loans usually have much lower interest rates than business loans. Often, no interest at all is charged. The cost of these emergency loans therefore needs to be covered in other ways (for example, by factoring it into the interest rate on business loans). To make sure that emergency loans are paid back, most village banks start to charge interest (or raise the interest rate) on emergency loans after a certain amount of time (e.g. 3 months) has lapsed from the issuing of the loan.
- **Available when they are needed**. Normally, village banks will handle loan applications and disbursements for business loans only on set days. However, since emergencies are by their very nature unforeseen, loans to cope with these situations should be given out when they are needed. This means that the village bank must keep some funds in reserve to be able to respond to its members' needs in cases of emergency.

Key issue 5: Repayment problems

When loans are not repaid as agreed, there can be negative consequences both for the village bank and for the borrower:

- Non-payments of loans can lead to financial losses. If borrowers fail to repay, the bank's capacity to operate may be affected, and it may not be able to continue issuing loans to members who need them. The village bank may also not be able to repay its own loan, if it has one (for example from an NGO or MFI). Worse than that, the members' savings will be lost.
- Late repayments are also not good for the village bank since they cause extra work for the management committee and limit the village bank's capacity to issue new loans.
- For the village bank members, repayment problems can lead to a cycle of debt. If a new loan is taken to repay the old one, and the new loan cannot generate enough income to pay it back, the borrower will become even more indebted.

Avoiding repayment problems is therefore important for both the village bank and its members. Ways of preventing repayment problems include:

1. Village bank members must **deposit savings** before they can apply for loans. The loan takers may lose these savings if they do not pay back their loans.
2. Village bank members are required to **pledge collateral** before receiving a loan.
3. Village bank members must find one or two **personal guarantors** for their loans who become liable in the case of non-repayment.
4. Village banks charge **fines on late repayments**. These fines would go to the village bank's fund.
5. Village banks **exclude members** who failed to pay their loan back from further loans.
6. Village bank members are **told in advance that their village bank will be cut off from future loans** if the loan it has received from a support organization is not paid back.

If the members' loans to the village bank are not repaid properly, there may be cases in which the village bank is unable to repay the loan it has obtained from the support organization/donor. If this happens, the loan giver can:

- Support the village bank's management and advisory committee in delinquency management
- Stop the village bank from issuing further loans to its members until the external loan has been repaid.

Annex 3.1. Sample Loan Contract

Lao People's Democratic Republic
Peace Independence Democracy Unity Prosperity

....

Province .... No.........................

District..............................

Village ....

Loan Agreement

1. Loan taker: Mr. / Ms. .... Member No: ....
2. Amount of loan: .... Kip Loan No: ....
3. Objective of the loan: ....
   ....
   ....
4. Term of the loan: .... months, from the (date): ....
5. Interest rate of the loan: .... % per month (monthly payment).
6. Number of loan capital payments: ....
7. Fine for late payments: ....
8. Date by which the loan must be repaid in full: ....
9. Names of Guarantors: 1. .... 2. ....
10. Collateral: ....

Village..........................date / / ....

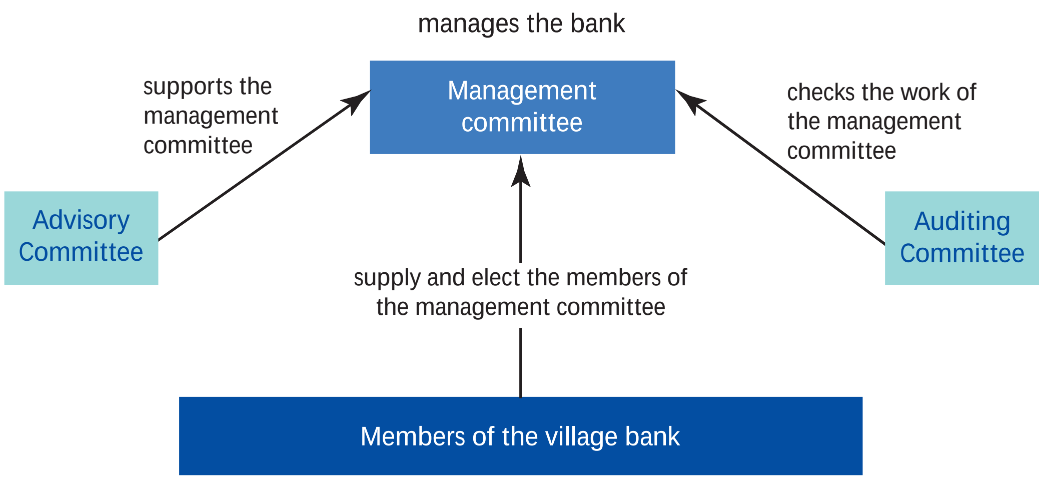
Signature of Treasurer Signature of Borrower

Signature of Guarantor 1 Signature of Guarantor 2

President of Village Bank Management Committee

CHAPTER 4. MANAGEMENT STRUCTURE

To be able to operate, every village bank needs a management structure.

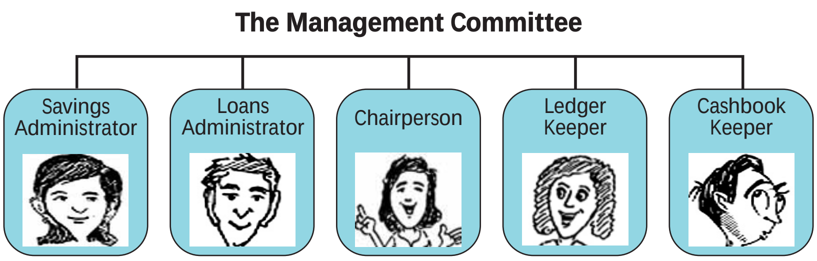


In most village banks, there is a management committee which is responsible for the general administration of the village bank and for managing savings and loans, as well as an advisory committee to support its work. In some village banks, there may also be an auditing committee to check the work of the management committee.

The Management Committee: what is it and what does it do?

The main roles of the management committee are to make sure that the village bank operates smoothly and to provide the following services:

- Inform members about operations and objectives of the village bank
- Manage membership (accepting new members, monitoring member fee payments)
- Collect and manage the savings of the members, and manage the commercial bank account of the village bank
- Carry out loan appraisal, disbursement and follow-up
- Organize meetings
- Check that members adhere to the regulations (see Chapter 6 on regulations)



Usually a management committee has five members, who are responsible for different aspects of administration. The structure may vary, but in many cases one member (the chairperson) will provide leadership and guidance, while the remaining members will each take care of one of the following: loan administration, savings administration, keeping the ledger and keeping the cash book (see Chapter 7 on accounting tools).

This division of responsibilities helps the committee to deal with the workload.

The committee members work together when deciding on general village bank issues, loan requests, or when dealing with problems such as late repayments.

The role of the Advisory Committee

In each village bank there is also an advisory committee. Unlike the management committee, in most villages it is not elected, but is composed of village leaders (usually the village chief and the representatives of the mass organizations).

The role of the advisory committee is to support the management committee in case of disagreement or in case of repayment problems. It can also play a meaningful role in promoting the village bank. It should not, however, influence loan decisions or undertake other tasks which should be performed by the management committee. Because it is usually not an elected body, it is especially important to make sure that it does not go beyond its advisory role (see also section on elections below).

Box 4.1. Auditing Committees

Not all village banks will have an auditing committee. In village banks where there is one, the committee has the role of checking the accounts of the village bank. The auditing committee is responsible for verifying whether the accounts give an accurate picture of the financial state of the village bank. Auditing is usually done annually. The members of the auditing committee should not be members of the management committee or of the advisory committee. It is also important that the work of the auditing committee is complemented by a formal audit by an independent, external auditor.

See Chapter 11 for more on auditing.

Elections & remuneration

Elections

The **management committee** is elected at regular intervals, usually once a year (in most cases after the surplus distribution).

In some cases, elections are held by hand-raising. This is not recommended, because it means that members may be pressured or influenced by others to vote for a certain person. Instead, elections should be held through voting by ballot, where each member indicates their chosen candidate on a slip of paper anonymously (which are then collected and counted), without others knowing who they voted for.

Holding these regular democratic elections is important because it allows the village bank members to influence the composition of the committee, and to replace committee members in case of unsatisfactory performance.

The members of **advisory committees** are initially usually not elected but chosen on the basis of their position in the village. While it is necessary to have the support of high-ranking members of the village and while their presence can help to strengthen adherence to the village bank rules, having an unelected committee is also risky for the village bank, as the committee cannot be controlled by the members or replaced through elections if it acts in way which is contrary to the members' or the village bank's interests. Therefore, in the long run it is advisable that village banks move to a more democratic advisory structure. For instance, village banks may opt to have a second, elected body to advise and control the management committee and to involve the village authorities not as a committee, but in a more informal way (e.g. by giving village authorities observer status in village bank meetings, and organizing occasional separate meetings with them).

Remuneration

The management committee is paid from the surplus of the village bank: when the yearly surplus is divided, a set proportion (usually around 15%) is given to the management committee. Like the management committee, the advisory committee receives a share of the annual surplus of the village bank (usually around 5%).

This means that the remuneration of the committees depends on the success of the bank. Because of this they will be likely to have an interest in making sure that the bank works as well as possible. However, as there is also a risk that committee members might be tempted to manipulate the financial results of the village bank to increase their earnings, independent audits are important for making sure that the calculation of the committees' salaries is free from fraud and based on actual surplus.

What should leaders be like?

The most important criterion when selecting the committee members is their capacity to carry out the duties associated with their position.

In many cases, people may have set ideas on the abilities or behaviour of certain individuals or groups which block their access to leadership positions.

For example, assumptions that old people are better leaders than young people are common. However, age is often not relevant: the person who will be responsible for the cash book, for instance, must be able to read, write and count, and record transactions carefully and reliably – it does not make a difference whether the person is old or young.

The choice of the management committee members should therefore be based on the skills and characteristics of the people.

The duties and characteristics of management committee members are listed in Annex 4.1.

Women's participation in the village bank leadership

In some village banks the management committee has a relatively balanced number of female and male members. In others, however, women are severely under-represented. In advisory committees, which are not elected but composed of village leaders, in many cases there are no women at all.

It is important to involve women in the management of the village bank because:

- it helps to give women more voice and power in the community, and also gives them a greater degree of control over issues that affect them
- it furthers development and poverty-reduction in the community, as women are known to put their loans to good use which benefits their whole family

- it helps the village bank to work better because 1) a greater involvement of women will also increase the attachment of women to the bank, and their commitment to making it work well; and 2) experience has shown that when women manage money, there is a lower risk of mismanagement, and the village bank's funds therefore are more likely to be well looked-after.

Ways to promote gender equality in the village bank's management structure include:

- awareness raising and training to make sure that everyone in the village understands the benefits of equality between women and men and ways of addressing inequalities
- for the management committee, specifying the number of women who should be elected to the committee (it is recommended that at least three of five committee members are women) and holding separate elections for women and men candidates to ensure that women are elected to the committee.

See also Chapter 5 on equality between men and women in village banks.

Annex 4.1. Responsibilities and characteristics of the members of the management committee[4]

Title	Role	Characteristics and qualities
The president	• Is the leader of the group • Leads meetings • Represents the group to outsiders • Ensures that the regulation is respected • Finds solutions to conflicts between members	• A person of strong character • Present and visible in the community • Capable of running a group • Understands the roles and responsibilities of the different committee members • Honest and intelligent • Patient, available, dynamic
The person responsible for the savings administration	• Records the savings of each member in the savings book • Records the savings of each member on the members' savings and loan cards • Counts the total amount of savings received	• Capable of recording savings transactions • Literate • Reliable and intelligent
The person responsible for the loan administration	• Records the loans given in the loan book • Records the loans and interest paid back in the loan book • Records the loans given and paid back on the members' savings and loan cards	• Capable of recording loan transactions • Literate • Reliable and intelligent
The person responsible for the cash book	• Records the amount of savings collected in the cash book • Records the amount of loans paid back in the cash book • Records the amount of fees collected in the cash book • Records the amount of loans given out in the cash book • Calculates the balance of cash	• Capable of recording transactions in the cash book • Literate • Reliable and intelligent
The person responsible for the ledger	• Fills in the ledger • Checks whether the amounts recorded in the ledger match the amounts in other financial statements	• Capable of recording transactions • Literate • Reliable and intelligent

[4] Adapted from ILO (2006). *Guidelines for the Formation of Self-Help Groups.*

CHAPTER 5. EQUALITY BETWEEN WOMEN AND MEN

In every community there are perceptions linked to what women and men are capable of doing, and how they should behave. This leads to differences between men and women in terms of their rights and responsibilities, and the opportunities, resources, and benefits that they have access to.

In Lao PDR women's skills and contributions to community life are in general valued. For instance, women are seen as good managers of money and are often assigned this role, especially within the family. However, people think that men are better in decision-making and leadership.

Therefore, there is a risk that women may not participate in and benefit to the same extent as men from the village bank. Differences in the roles of men and women in the community and expectations towards their behaviour mean that women's involvement in decision-making in the village and therefore the village bank may be lower than men's because, for example:

- Men tend to have had more educational opportunities and are more often literate than women. Men also tend to be more prominent in public life – for instance they usually attend village meetings more frequently than women and are more directly involved in decision-making relating to village affairs.
- Women tend to shoulder primary responsibility for household work, meaning they have less time than men to attend meetings. Often they are also not expected to voice their opinions or to interact with village authorities in the same manner as men.

Why promote equal participation between men and women?

Gender equality is about giving women and men equal rights and ensuring a fair balance between them in terms of responsibilities, workload, decision-making power and income.

Promoting gender equality in and through village banks is both the "right" and the "smart" thing to do:

- **Village banks can help to empower women.** Participating in the village bank as members and managers helps to increase women's self-confidence and status in the community. The savings and loan facilities provided by the banks mean that women have better access to and control over financial resources, which can help them, among other things, to improve their businesses.

- **Gender equality is a key condition for the success of the village bank.** Giving both women and men the opportunity to participate in and manage the village bank means that the valuable skills and contributions of all members of the community are used and are not wasted. This is particularly important as Lao women usually have significant experience in managing money. Making sure that both men and women can participate fully as members and managers of the village bank also means that the members are more likely to take an interest in the success of the bank and feel more bound its rules and policies, and less likely to default.

The Government of Lao PDR is committed to achieving gender equality, as the national laws and policies guaranteeing equality between men and women, and the efforts to realize the Millennium Development Goals, clearly indicate. Promoting equal participation in and through village banks also helps to achieve these goals.

Ways of promoting gender equality in village banking

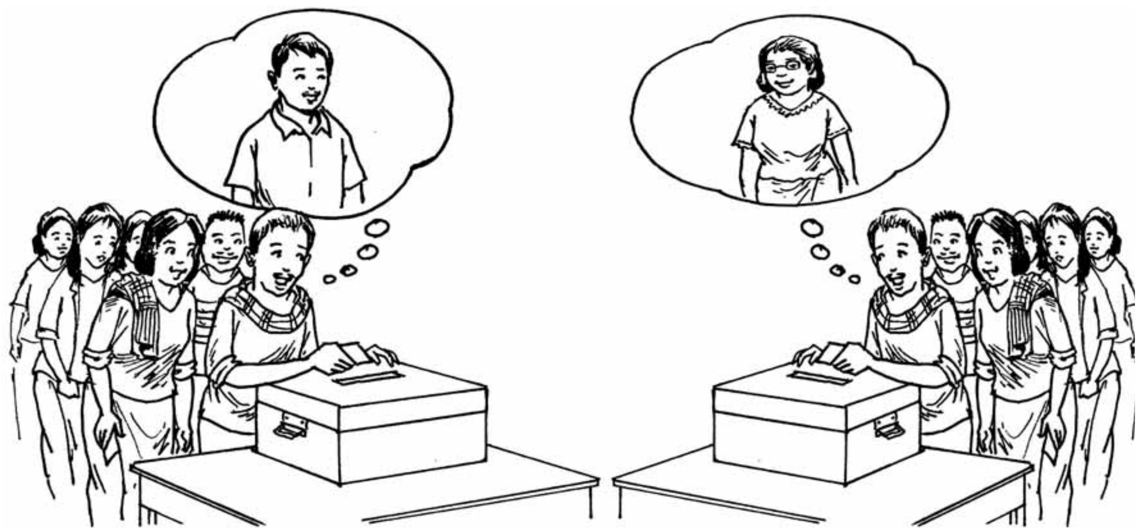
There are many ways in which village banks can promote gender equality. Some examples are given below:

- **Promoting women's and men's membership.** When promoting the village bank among villagers, the needs of both women and men should be addressed. If promotion is done only during meetings where men are present, women may not receive the same information on the bank, and may not be equally aware of the benefits of membership. When deciding on village bank membership requirements, it is important to check that they do not make it difficult for women to become members. For example, a literacy requirement would in most cases make it impossible for a larger number of women than men to become members.

- **Awareness-raising on the importance of gender equality.** The village bank leaders, especially the advisory committee, whose opinion is respected in the village, can emphasise the importance of gender equality in the village bank, both among the managers of the bank and among the members. It can encourage husbands and wives to share household work equally so that both can participate actively in the village bank. It can also explain the importance of sharing responsibility and decision-making over financial issues in the family, which leads to a better use of money that benefits all family members.

- **Equal participation in meetings and in village bank affairs.** When the village bank arranges meetings, it should try to make sure that both women and men participate. This means that the meetings should not take place at times when women cannot participate because of family or community responsibilities. It also means that both women and men should be reminded of the importance of everyone attending meetings. Sometimes even though women are present at meetings, they may be reluctant to speak up because they feel they are not expected to or because they are not used to doing so. Because of this, the village bank managers should always try to make sure that women are also consulted during meetings, and encouraged to express their opinions.

- **Holding separate elections.** Holding separate elections for male and female members of the committee will help to make sure that women are not under-represented in the management committee. In this case a specified number of seats is reserved for women and is filled through an election with only female candidates, and the same procedure is carried out for posts to be filled by men.



The ILO encourages the village banks it supports to reserve at least three out of five posts for women, as this helps to give them confidence in their work and in interactions with other management committee members, and ensure that their views are not disregarded.

Making sure that women are present on the management committee is especially important because their number in the advisory committee is often very low, if they are present at all.

- **Ensuring equality within the committees.** Just having the same number of women and men (or even a higher number of women) on the committees does not mean that women are given the same amount of decision-making power within the committee. Both the management and advisory committee should give male and female committee members the same amount of responsibility and give equal recognition to their opinions and suggestions.

See also Part III for steps that support organizations can take to promote gender equality.

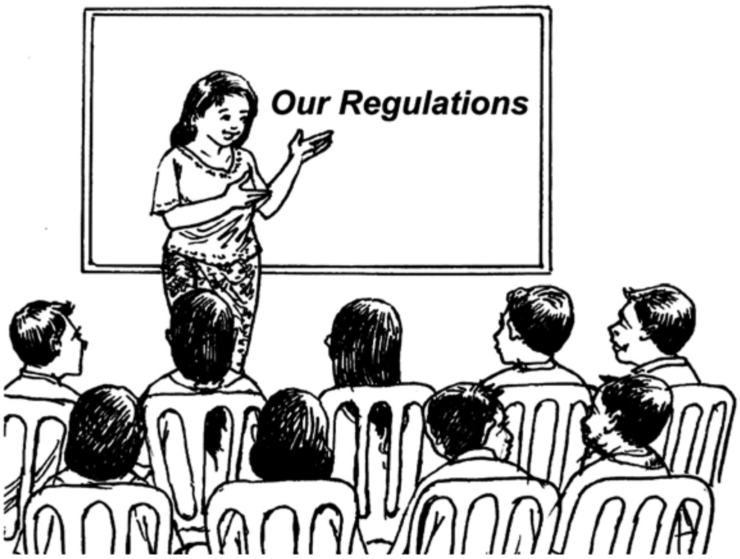
CHAPTER 6. RULES AND REGULATIONS

Why do village banks need rules?

Each village bank needs to have rules and regulations which outline how the bank will work in terms of issues such as: leadership structure, financial organization, membership, and loans and savings policies.

Having such rules is important for the success of the village bank because they help to ensure that:

- Members understand their rights and duties
- The committee members understand their roles and responsibilities
- The terms and conditions for saving and taking loans are known and accepted by all
- Disagreements and abuses are prevented



What should rules be like?

The rules of the village bank should be:

- **Decided on and accepted by all members.** Although the rules may be formulated by the management committee, before they become operational, they must be approved by the majority of members (through a minimum of 2/3 of the votes at a general meeting where at least 50% of the members are present).
- **Clear and easy to understand** and **accessible to members** in writing.
- **Enforceable.** There should be a way of checking and making sure that the rules are followed.
- **Changeable.** The situation of the village bank and the needs of the members may change over time, meaning that the rules must be changeable. Changing the rules too often, however, would create instability in the bank, which is why the modalities for revising the rules should be clearly defined.
  - Ideally, rules should only be changed at general meetings with the agreement of the majority of the members (through a minimum of 2/3 of the votes in a meeting where at least 50% of the members are present).
  - While most aspects of the rules (e.g. number of committees and committee members do not usually require changing from one year to another, the rules should make provision for a yearly review of policies which might require adjusting. These include 1) the loan conditions and 2) the shares of yearly surplus which will be allocated to different purposes at the end of the year. Some village banks may not include these two points in their general village bank rules, but instead have separate rule documents for them, approved by the members in the same way as the general rules.

What should the regulations contain?

Every village bank will have slightly different rules depending on its situation. As a minimum, they should cover the following issues:

1. Membership criteria. The rules should state:

- **Who can become a member.** In most cases, only residents of the village can join the village bank. Membership should be voluntary, and open to both women and men. The rules may specify that children under 16 can become members but are not allowed to take loans.
- The **obligations of members**, such as payment of membership fees or attending meetings.

2. Management structure/committees. The rules need to identify:

- The **types of committees** that the village bank will have (e.g. a management committee and an advisory committee).

- What the **composition of the committees** is. Since women are often under-represented on village bank committees, it is useful to state how many committee members should be women (for more information, see Chapter 5 on Gender Equality).
- **How they are chosen.** In the case of the management committee, the rules should establish how they are elected and at what intervals (e.g. once a year through election by ballot, with at least 70% of members present). To make sure that women are elected to the committee, the rules can also state that separate elections will be held for female and male candidates.
- What their **roles and responsibilities** are. It is important to clearly outline what the roles of the different committees and of the individual committee members are. This will help to ensure that all of the work gets done, and that the different committees and committee members only undertake actions which are within their area of responsibility.
- How they will be **remunerated**. The rules should state how the different committees will be compensated for their work. In most village banks, they receive a percentage of the yearly surplus of the bank.

See also Chapter 4 on the management structure.

3. Savings modalities. The rules should specify how savings are deposited (e.g. they may state on which day savings can be put into the fund).

The rules of some village banks may also stipulate minimum amounts of savings to be deposited per month. This is not recommended, however. Given differences in the financial situation and needs of the members, imposing such a fixed savings requirement on members is likely to lead to their unwillingness and/or incapacity to use the bank.

4. Loan modalities and criteria. The rules should state:

- What different **types of loans** the village bank gives out (e.g. business loans and emergency loans)
- The **interest rate**(s) and **maximum loan term**(s) for the different types of loans provided
- **How loans are obtained** (i.e. through an application submitted to the management committee for approval). The rules may also specify on which day loans can be applied for or are disbursed to applicants.
- What the **conditions for obtaining a loan** are, such as not having any outstanding unpaid loans, having one or more guarantors to guarantee the loan, or depositing a specified amount of savings prior to obtaining a loan.

See Chapter 3 for more on loan policies.

Savings modalities and loan conditions may be included in the general rules of the village bank if provision for periodic (e.g. yearly) review and adjustment is made in the rules. Some village banks may choose to have a separate document on savings modalities and loan conditions in addition to general village bank rules.

5. Surplus distribution. The rules should establish what is done with the yearly surplus of the village bank, i.e. when it is distributed, and how much of it should be allocated for the remuneration of the committees, savings interest for members, capital for the fund, and to cover the costs of services such as auditing.

The surplus shares division may be included in the general rules of the village bank if provision for periodic (e.g. yearly) review and adjustment is made in the rules. Alternatively, a village bank may choose to not indicate the shares in the general rules, but to have a separate document defining the way surplus will be divided at the end of the year.

An example of village bank rules is given in Annex 6.1.

Annex 6.1. Example of Village Bank Rules

General Rules of the Village Bank of Pung Neua

1) General provision

The purpose of these rules is to govern the establishment, operation and financing of the village bank of Pung Neua.

2) Membership

i. Membership is household-based, and both women and men can become members
ii. To become a member, a person has to be registered in the household book of the village
iii. Becoming a member is voluntary
iv. After joining the village bank, members must pay for their passbook (10,000 Kip) and the membership fee (25,000 Kip)
v. A person's membership will be terminated:
   - if the person moves to another location
   - when the person volunteers to leave

   Whoever leaves the bank during the year will receive all the money that he or she deposited, but will not receive savings interest before the end of the year.

3) Source of funds

i. savings of members
ii. interest on loans given to members
iii. interest on savings deposited in a bank
iv. a share of the previous year's surplus
v. initial membership fee
vi. external loans

4) Savings modalities and loan conditions

The general savings modalities and loan conditions are defined once a year at a general meeting. The savings modalities and loan conditions must be approved by 2/3 of the votes, with at least 50% of members present. If necessary, they can be amended during the year at a second general meeting specifically organized for that purpose. Once adopted at the general meeting, they will be published in the Savings Modalities and Loan Conditions document, which must be followed by the committees and the members. The loan conditions will include the interest rate, maximum loan term(s) and size(s), guarantees required, and other items as deemed necessary during the meeting.

5) Committees

i. Management Committee
The management committee consists of 5 persons. At least 3 of the committee members must be women. Becoming a committee member is voluntary, and the committee is elected by the village bank members.

The roles and responsibilities of the management committee are:
- To decide on membership
- Financing, accounting, book-keeping
- Implementing regulations
- Representing the members
- Consideration of members' loan applications
- Organizing the yearly general meeting of village bank members
- Producing an annual report for the general meeting
- Organizing meetings
- Organizing the surplus distribution according to the rules of the village bank
- Proposing how to divide the percentage of the surplus which goes to the committee among themselves

The responsibilities of the individual management committee members:
- President – general management
- Vice president – responsible for cash (keeping the cash book)

- Third committee member – general accounting (keeping the ledger)
- Fourth committee member – saving accounting (keeping the savings book)
- Fifth committee member – loan accounting (keeping the loan book)

The committee will be elected for a period of 1 year, after which a new election will be held. Female and male members of the committee will be elected separately.

ii. Advisory Committee

During the first year of operation of the village bank, the advisory committee will consist of: the village head, representatives of the Lao Youth Union, the Lao Women's Union, and the Lao National Front.

The roles and responsibilities of the advisory committee are:

- Evaluating the work of the management committee
- Monitoring and auditing the accounting of the fund
- Monitoring interest and loan repayments in case of problems
- Membership mobilization
- Problem-solving

Before the second year of operation of the village bank, the members will hold a general meeting to decide whether the advisory committee will become an elected body.

6) Surplus distribution

The surplus of the village bank will be distributed once a year. The surplus will be used for purposes such as: savings interest for members, payment of the management and advisory committee, village bank capital, village development capital, welfare capital and auditing.

The shares (as a percentage of the surplus) allocated to different purposes are decided on once a year at a general meeting.

The allocation must be approved by 2/3 of the votes, with at least 50% of members present. The allocation will be published in the Rules on Surplus Distribution, which will be valid for the year, until surplus is distributed.

7) General meeting and decision-making

i) Purpose of general meetings

- General meetings of all members can be organized whenever necessary, but general meetings must take place each year for the following purposes:
  1) deciding on loan conditions
  2) deciding what the shares of surplus allocated to different purposes at the end of the year will be
  3) distributing the village bank's yearly surplus
- A general meeting must be called to modify these rules
- Additional general meetings can be organized as necessary.

ii) Decision-making at meetings

- A representative of the committees may chair the general meeting, but decisions during the meeting are taken by members
- To be binding, any decision must be approved with at least 2/3 of the votes of those present in the general meeting, who must represent at least 50% of the members.

8) Final provision

To be applicable, these regulations must be approved by the general meeting of all members.

Approved by the general meeting

Ms. Somchay, Village Bank President, 30/1/2008

Village Bank of Pung Neua – Surplus Distribution Rules

The members of the village bank hereby agree that the surplus of the village bank will be distributed as follows in 2008:

Percentage of surplus to be distributed for different purposes:

Savings interest for members	70%	Village development capital	2.5%
Payment of management committee	15%	Welfare capital	2.5%
Payment of advisory committee	5%	Auditing costs	2%
Capital	3%		

Organization of distribution:

- Unless agreed otherwise at a second general meeting, surplus distribution will take place on 20/12/2008
- The management committee will calculate the yearly surplus of the village bank and submit the calculations for checking by the advisory committee and the auditing committee
- The management committee will chair the meeting and ensure that the right share is given out for each purpose. The advisory committee and auditing committee will monitor the meeting and check that it is conducted properly.

Approved by the general meeting

Ms. Somchay, Village Bank President, 2/2/2008

Village Bank of Pung Neua – Savings Modalities and Loan Conditions

The members of the village bank hereby agree that the Savings Modalities and Loan Conditions for 2008 are as follows:

Savings modalities

- Members can deposit or withdraw savings on the last Tuesday of each month.
- Members can deposit any amount that they wish, and there is no obligation to deposit.
- Member deposits or withdrawals will be recorded in the member's passbook and in the savings book.

Loan conditions

Loan requests can be submitted on the last Tuesday of each month. **Loan disbursements** will be made on the last Thursday of each month. Disbursements and loan capital and interest repayments will be recorded in the loan book.

The **interest rate** will be: i. 3% per month for business loans and ii. 1% per month for emergency loans only on the outstanding balance. The interest rate on late repayments is 5% per month.

The **maximum length** of the loan is 6 months for business loans and 3 months for emergency loans.

To get a loan, a member must:

- Have repaid all previous loans
- Have collateral and at least two guarantors
- Be over 16 years of age
- Submit an application form to the committee for consideration and approval, and sign a loan contract
- Have been a member for at least three months

And the size loan must:

- can be only 1-5 times the amount of savings deposited by the member
- cannot exceed 2 million Kip
- must not represent over 10% of the total portfolio

Approved by the general meeting

Ms. Somchay, Village Bank President, 4/2/2008

CHAPTER 7. ACCOUNTING

Village bank accounting systems

Keeping financial records is important for village banks because it:

- **Helps to control cash.** Records show how much cash the village bank should have and help to make sure that money does not disappear or is unaccounted for. For example, records can be used to check whether all interest and loan capital repayments have been made as agreed.
- **Helps to show how the village bank is doing** – i.e. is it covering its costs? is it making surplus?
- **Increases the members' confidence** in the bank since they can see what is happening with their money.
- **Gives information to outsiders** (such as the local authorities or support organizations) about the state of the village bank. Being able to present up-to-date, accurate financial records can be helpful if the village bank applies for a loan for instance. In many cases, having these records is also required by law/regulation.

Most village banks (for instance those supported by the ILO) use a simple, manual system consisting of some/all of the **tools** below:

Passbook	Each individual member's passbook shows the details of his/her savings deposits and withdrawals.
Savings Book	The savings book shows the details of all of the members' savings records (i.e. dates and amounts of the deposits of each member).
Loan Book	The loan book shows the details of all of the loans issued by the village bank. For each loan issued, it shows information on the loan taker, the amount, the loan term and interest rate, and details of interest payments and loan capital repayments made.
Cash book	The cash book shows all of the money that has come in and gone out during each month.
Ledger	The ledger shows money in/money out by the type of item involved. For example, it shows how much was spent on external interest payments, or how much was earned from membership fees.
Income and Expenditure Statement	The income and expenditure statement summarizes the income and expenditure of the village bank over the year, and is used for determining the net surplus or loss of the village bank.
Balance Sheet	The balance sheet shows the net worth of the bank by summarizing the bank's assets, liabilities and equity.

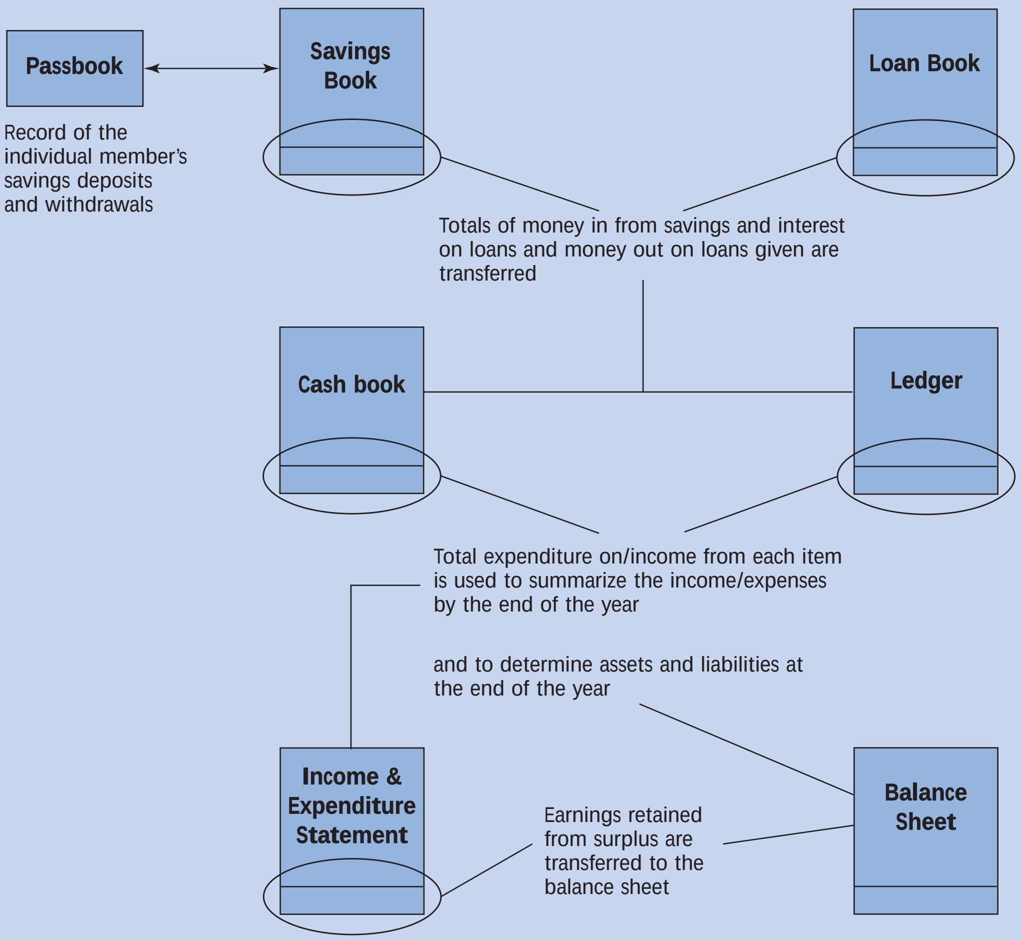
Box 7.1 explains how these different accounting tools are linked to each other. Section II of this chapter gives a more detailed overview of each tool.

As explained in Chapter 4, the accounting work is often divided among the **management committee** members, with one member often taking care of one of the following: savings administration, loan administration, keeping the cash book and keeping the ledger. While each member has primary responsibility for one area of accounting, they need to work together to cross-check the records and make sure that the same procedures are followed when filling in the tools and that the amounts recorded in each tool match the entries in the other tools.

While accounting systems may vary somewhat from one village bank to another, it is important for the village bank's success that records are:

- **Up-to-date, accurate and complete.** Entries need to be made regularly, and all of the details of each transaction should be recorded as appropriate, according to the correct procedure.
- **Transparent and accessible.** The records should be kept in a way that can be easily understood by members/outsiders, and they should be shown on request.
- **Checked.** The committee should perform regular internal cross checking to make sure that all of the entries in the different tools are correct and match. Records should also be checked through a formal audit (see Chapter 11).

Box 7.1. Village Bank Accounting Tools



Overview of accounting tools

Loan and savings administration

❖ Individual passbook

Each village bank member has his or her own passbook in which savings transactions are recorded. It allows members to check their current balance, and to see the details of all of the deposits and withdrawals that they have made.

Whenever a member deposits money in the village bank, or withdraws money, the member's passbook is updated with the following:

- The number and date of the transaction
- The amount deposited or withdrawn
- The new balance following the transaction

Member passbook

Name: Mr. B (Member No. 001)

No.	Date	Deposit	Withdrawal	Savings interest	Balance	Initial
1	1/1/08	20,000			20,000	
2	1/2/08	20,000			40,000	
3	1/3/08	20,000			60,000	
4	1/4/08		10,000		50,000	
5	1/5/08	30,000			80,000	
6	1/6/08	20,000			100,000	
7	1/7/08	20,000			120,000	
8	1/8/08		20,000		100,000	
9	1/9/08	20,000			120,000	
10	1/10/08	20,000			140,000	
11	1/11/08	10,000			150,000	
12	1/12/08	20,000			170,000	
13	28/12/08	Savings interest		20,252	190,252	

At the end of the year, the interest that has been earned on the savings is recorded in the passbook. The interest is calculated based on the cumulative savings ("points") of the members (see Chapter 8 on savings interest calculation).

❖ Savings Book

The savings book is used for recording the deposits of the village bank members. Whenever a member puts money in the village bank, a note of the transaction is made.

The savings book shows how much money each member has deposited each month, and the total amount of savings that each member has accumulated.

The savings book is filled in as follows:

During the year, the savings of each member are recorded using two separate rows:

- each month, the amount deposited (which can also be zero) is entered into the first row in the column corresponding to that month.
- each month, the value of the cumulative deposits of the member is entered into the second row in the column corresponding to that month. These cumulative deposits are called "points", since they measure savings performance, and are used to calculate how much interest a member will receive on his or her savings at the end of the year (see Chapter 8).

At the end of year, the numbers in each row are added up and entered into the last column, which shows 1) the total amount of savings and 2) the sum of the cumulative savings ("points").

For example, as shown below, Ms. A's:

- monthly **deposits** (20,000 Kip each month) are recorded in the first row during the year. At the end of the year, these deposits are added up, and the sum (240,000) is shown in the last column.
- her **cumulative savings ("points")** are shown on the second row: i.e. after the 1st month her savings balance is 20,000, after the 2nd month it is 40,000, after the 3rd month it is 60,000, and so on.

Savings Book

No.	Name		1	2	3	4	5	6	7	8	9	10	11	12	Total
			9/03	10/03	11/03	12/03	01/04	02/04	03/04	04/04	05/04	06/04	07/04	08/04	
001	Ms. A	**1**	**20,000**	**20,000**	**20,000**	**20,000**	**20,000**	**20,000**	**20,000**	**20,000**	**20,000**	**20,000**	**20,000**	**20,000**	**240,000**
		2	20,000	40,000	60,000	80,000	100,000	120,000	140,000	160,000	180,000	200,000	220,000	240,000	1,560,000
002	Mr. B	**1**	**100,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**210,000**
		2	100,000	110,000	120,000	130,000	140,000	150,000	160,000	170,000	180,000	190,000	200,000	210,000	1,860,000
003	Ms. C	**1**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**100,000**	**210,000**
		2	10,000	20,000	30,000	40,000	50,000	60,000	70,000	80,000	90,000	100,000	110,000	210,000	870,000

❖ The Loan Book

The loan book is used for recording information on the loans given out to members. A record is made of each loan that is given out, which includes information on:

- the name and membership number of the loan taker and the loan contract number
- the activity for which it is taken out
- the amount disbursed and date on which the loan was issued
- the loan term and the interest rate
- the dates and amounts of loan capital repayments and interest payments made
- the outstanding balance after each instalment.

Whenever a transaction takes place, the details are recorded into the appropriate column, and the entry is signed by the loan administrator.

As explained in Chapter 3, interest payments are calculated based on the "declining balance" method, which means that the outstanding balance, rather than the initial sum disbursed, is used for calculating the amount of each interest payment. Therefore, for each interest payment, the amount from the last entry in the column "outstanding balance" is multiplied by the interest rate to obtain the amount of interest that is to be paid.

Loan book

No.	Name	No. of member	Date of loan	Contract No.	Activities	Loan amount	Loan period (month)	Interest rate (per month)	Payments (Kip)					SIGNA-TURE
									Date of payment	Loan	Repayment of loan capital	Interest payment	Out-standing balance	
1	Ms. A	02	1/1/08	01	Trade	3,000,000	6 months	3%	1/1/08	3,000,000			3,000,000	
									1/2/08		–	90,000	3,000,000	
									1/3/08		1,000,000	90,000	2,000,000	
									1/4/08		–	60,000	2,000,000	
									1/5/08		1,000,000	60,000	1,000,000	
									1/6/08			30,000	1,000,000	
									1/7/08		1,000,000	30,000	0	

PRESIDENT OF VILLAGE BANK DATE.............................

INITIALS

Monthly cash records

❖ Cash book

The cash book is a record of all the money that is coming in and going out through cash transactions for each month. It shows each item in chronological order as well as the updated balance after each transaction. It also shows the total of money in and money out and the balance at the end of the month.

This example of a cash book has 5 columns which need to be filled in whenever a cash transaction occurs. The information that needs to be entered includes:

- The date of the transaction (column 1) and the item (e.g. receiving membership fees or selling passbooks to members) (column 2)
- How much money came in (column 3) or went out (column 4)
- The remaining balance after the transaction is added to or subtracted from the previous balance (column 5)

Cash book (for the month 2/08)

Date	Item	Money In	Money Out	Balance
1/2/08	Previous balance			6,610,000
1/2/08	Membership fees	225,000		6,835,000
1/2/08	Revenue from passbooks	300,000		7,135,000
1/2/08	Member deposits	3,000,000		10,135,000
3/2/08	Pay back old loan to government		2,000,000	8,135,000
3/2/08	Interest on government loan		100,000	8,035,000
5/2/08	New loan from government	3,000,000		11,035,000
7/2/08	District subsidy	2,000,000		13,035,000
10/2/08	Interest from members	400,000		13,435,000
15/2/08	Member loan repayments	1,000,000		14,435,000
16/2/08	Loans to members		7,000,000	7,435,000
18/2/08	Stationary		500,000	6,935,000
	Total	**9,925,000**	**9,600,000**	**6,935,000**

Balance in the past month:	6,610,000 Kip	Date:
Money in during the month:	9,925,000 Kip	Accountant:
Money out during the month:	9,600,000 Kip	Village bank head:
Balance transfer:	6,935,000 Kip	Committees:

At the end of the month, all of entries in the "money in" and "money out" columns should be added up, and the total money out should be subtracted from the total money in to obtain the balance at the end of the month.

❖ Ledger

The ledger is used to show money in and money out by the type of item (e.g. membership fees, loans, or interest).

Transactions which concern the same item are grouped together in the ledger, and at any given time, the ledger will show the money in or money out relating to a particular type of item.

The categories of items in the ledger used by ILO-supported village banks are:

- Cash on hand
- Cash in the bank
- Member savings
- Loans to members
- External loans
- Interest received and paid
- Income from sale of passbooks
- Capital
- Income from membership fee
- Other expenses

For each of these categories, there is a column for “credit” (or the equivalent), a column for “debit” (or the equivalent) and a column for “balance”.

When a transaction has taken place, it is recorded in the ledger. For example, when money comes in from the sale of membership books, the amount is entered into the corresponding sections of the ledger. In this case, two categories are involved:

- since the transaction involved cash, the amount is recorded in the “cash on hand” section, under the “credit” column (since in this case it involved money coming in, rather than going out).
- the amount is also recorded in the “income from sale of passbooks” section.

It is important to check that the amounts in the ledger correspond to the amounts in the other record keeping tools: for instance, the items under the heading “cash on hand” should correspond to those recorded in the cash book (see above).

At the end of each month, it is also important to check that the amounts in the ledger balance. This should be done with the following equation:

balance of cash on hand = savings balance - loan balance + external loan balance + interest received + income from passbook + capital + income from membership fee – other expenses.

In the example ledger on the following page, the two sides of the equation are equal (6,935,000 = 12,000,000 - 16,000,000 + 4,000,000 + 1,100,000 + 500,000 + 6,000,000 + 435,000 - 1,100,000)

If after checking the two sides of the equation are not equal, something is wrong and the entries should be re-checked.

The ledger is used to prepare end-of-year financial statements, such as the income and expenditure statement and the balance sheet. See also the guide on “Using the Ledger” that accompanies this handbook.

Example of a Ledger

No.	Month	Date	Item	No. of members	Cash on hand			Cash in the bank			Member Savings			Loans to Members			External Loans		
					Credit 1	Debit 2	Balance 3	Deposit 4	Withdrawal 5	Balance 6	Deposit 7	Withdrawal 8	Balance 9	Extended 10	Paid back 11	Outstanding balance 12	Loan received 13	Repayments 14	Outstanding balance 15
1	1	1	Previous balance				6,610,000						9,000,000			10,000,000			3,000,000
2	1	1	Membership fees	150	225,000		6,835,000												
3	1	1	Revenue from passbooks	150	300,000		7,135,000												
4	1	1	Member deposits	150	3,000,000		10,135,000				3,000,000		12,000,000						
5	1	3	Pay back old loan to government			2,000,000	8,135,000											2,000,000	1,000,000
6	1	3	Interest on government loan			100,000	8,035,000												
7	1	5	New loan from government		3,000,000		11,035,000										3,000,000		4,000,000
8	1	7	District subsidy		2,000,000		13,035,000												
9	1	10	Interest from members		400,000		13,435,000												
10	1	15	Member loan repayments		1,000,000		14,435,000								1,000,000	9,000,000			
11	1	16	Loans to members			7,000,000	7,435,000							7,000,000		16,000,000			
12	1	18	Stationary			500,000	6,935,000												
			End balance				6,935,000						12,000,000			16,000,000			4,000,000

No.	Month	Date	Item	No. of members	Interest			Capital			Income from sale of passbooks		Income from membership fee		Other expenses		Remarks
					Received from members 16	Paid on external loan 17	Balance 18	Received 19	Paid 20	Balance 21	Received 22	Balance 23	Received 24	Balance 25	Paid 26	Balance 27	
1	1	1	Previous balance				800,000			4,000,000		200,000		210,000		600,000	
2	1	1	Membership fees	150									225,000	435,000			
3	1	1	Revenue from passbooks	150							300,000	500,000					
4	1	1	Member deposits	150													
5	1	3	Pay back old loan to government														
6	1	3	Interest on government loan			100,000	700,000										
7	1	5	New loan from government														
8	1	7	District subsidy					2,000,000		6,000,000							
9	1	10	Interest from members		400,000		1,100,000										
10	1	15	Member loan repayments														
11	1	16	Loans to members														
12	1	18	Stationary												500,000	1,100,000	
			End balance				1,100,000			6,000,000		500,000		435,000		1,100,000	

End of year financial statements

❖ Income and expenditure statement

The income and expenditure statement summarizes the income and expenses of the village bank during a specified period of time (usually for the year).

- **Income** refers to the money that the village bank has earned during the specified period. This can include, for instance, interest from loans given to members or membership fees.
- **Expenses** refer to the costs of goods and services used by the village bank. These costs can include items such as operating expenses and interest paid on external loans.

Income and Expenditure Statement 2007			
Expenses		Income	
Operating expenses	1,379,500	Interest collected from members	13,734,000
Interest paid on external loan	4,380,500	Membership fees	381,000
		Selling passbooks	419,000
Total expenses	**5,760,000**	**Total income**	**14,534,000**
Surplus = 8,774,000			

The statement is used to determine what the **surplus or loss of the village bank** is, which is found by calculating the difference between income and expenses. In the example above, the village bank's surplus is 8,774,000 Kip (14,534,000 Kip - 5,760,000 Kip).

During surplus distribution, the surplus will be divided up for different purposes – most will be given to the members as savings interest (see Chapter 8), some of it will be used to pay the management and advisory committee, and some will go towards audits. What is not distributed to outsiders is kept by the village bank and added to its capital – this is the net surplus that it retains. In the example below, the share kept by the village bank is 3% ("capital").

	Share of Surplus	Amount
Savings interest for members	70%	6,141,800
Payment of management committee	15%	1,316,100
Payment of advisory committee	5%	438,700
Capital	3%	263,220
Village development capital	2.5%	219,350
Welfare capital	2.5%	219,350
Auditing costs	2%	175,480

The income and expenditure statement is linked to the balance sheet because the earnings retained by the village bank are transferred from the income and expenditure statement to the balance sheet as "capital" (see section on balance sheet below).

❖ Balance Sheet

Usually at the end of the financial year, a balance sheet is prepared.

The balance sheet shows what the village bank's financial position at that specific point in time is.

It is a summary of what "assets", "liabilities" and "capital" the village bank has:

- **Assets** are what the village bank **owns**, or what is **owed to the village bank**. This includes items that it owns, such as equipment (e.g. a safe or a computer), or the cash it has on hand or in a bank account. It also includes loans that it has given to members (since this money is only temporarily given to the loan takers, and will be given back to the village bank).
- **Liabilities are** what is **owed by the village bank to others**. For example, village banks often have an external loan which must be paid back. The savings that the members have deposited in the bank will also have to be returned one day.
- **Capital** refers to the **part of the surplus kept by the village bank** after savings interest distribution. Capital can also include grants given to the village bank or reserves made to protect the village bank against loan losses.

Balance Sheet September 2007			
Assets		**Liabilities**	
Cash in hand	9,392,220	Savings from members	49,970,000
Bank account		Loan from project	43,659,000
Loans to members	84,500,000		
		Capital	
		Surplus added to village bank capital	263,220
	93,892,220		**93,892,220**

The example of a balance sheet prepared after surplus distribution above shows that when the items are added up, the two sides of the balance sheet equal each other (both the sum of assets and the sum of liabilities and capital is 93,892,220).

This is a general rule: **assets = liabilities + capital.**

This is because all of the assets are funded by outside parties (liabilities) or capital, and the amount of assets must equal the funding sources. What the balance sheet presents are actually two ways of looking at the same resources of the village bank, one side of the sheet showing the assets and the other the way they are funded.

CHAPTER 8. SAVINGS INTEREST CALCULATION

If the village bank works well, it will have some funds left over once costs have been covered.

At the end of each year, the surplus of the village bank is divided up for different purposes. The share that is used for each purpose is decided in advance, usually at a general meeting as explained in Chapter 6, and it should be stated in the village bank's general rules or in a separate document.

A common way of dividing the surplus in ILO-supported village banks is shown in the box. As mentioned earlier, the needs and financial situation of the village bank will change as it grows, and a more developed village bank will be likely to benefit from adjusting this allocation by increasing the amount kept as capital, and if necessary, reducing the percentage paid to the committees (whose remuneration might otherwise become disproportionately high in relation to the amount of time spent on the work). As explained in Chapter 3, most of the surplus – often around 70% – is usually distributed as **savings interest** among the members.

Surplus of the village bank	
Interest for members	70%
Payment of management committee	15%
Payment of advisory committee	5%
Capital	3%
Village development capital	2.5%
Welfare capital	2.5%
Auditing costs	2%

This chapter explains how the amount of money that each individual member receives as savings interest is determined and calculated.

What is the amount of savings interest that a member receives based on?

The interest that members receive is based on their **savings performance**. This means that a person who is a regular saver and has saved a large amount over the year will receive a greater share of the surplus than a person who rarely saves and whose deposits are small.

The savings performance of a member is calculated on the basis of his or her **cumulative savings**, which are called **"points"** and are recorded in the savings book.

❖ How are points recorded and calculated?

Whenever a deposit/withdrawal is made, the amount is added to or subtracted from the balance from the previous time to obtain the current savings balance (balance of points). The balance is recorded in the 2nd row of each member's section.

As shown in the example below, Ms. A's savings balance therefore increases as follows:

- 20,000 after the 1st month (balance of 0 + new deposit of 20,000)
- 40,000 after the 2nd month (balance of 20,000 + new deposit of 20,000)
- 60,000 after the 3rd month (balance of 40,000 + new deposit of 20,000), etc.

No.	Name		1	2	3	4	5	6	7	8	9	10	11	12
			9/03	10/03	11/03	12/03	01/04	02/04	03/04	04/04	05/04	06/04	07/04	08/04
001	Ms. A	1 (deposits)	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000
		2 (savings balance/points)	20,000	40,000	60,000	80,000	100,000	120,000	140,000	160,000	180,000	200,000	220,000	240,000

At the end of the year, these amounts are **added up**: 20,000 + 40,000 + 60,000 + 80,000 + 100,000 + 120,000 + 140,000 + 160,000 + 180,000 + 200,000 + 220,000 + 240,000 = **1,560,000**

The **sum of the savings balances (points)** is recorded in the savings book in the "Total column":

No.	Name		1	2	3	4	5	6	7	8	9	10	11	12	Total
			9/03	10/03	11/03	12/03	01/04	02/04	03/04	04/04	05/04	06/04	07/04	08/04	
001	Ms. A	1 (deposits)	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	240,000
		2 (savings balance/points)	20,000	40,000	60,000	80,000	100,000	120,000	140,000	160,000	180,000	200,000	220,000	240,000	1,560,000

❖ Why are "points" used?

In the example above, the total amount of "points" that Ms. A accumulated during the year was 1,560,000. This figure is different from the sum of her deposits during the year, which was 240,000.

Why is the sum of points (rather than the sum of deposits) used to determine the interest that she will receive? Because the points are a better indicator of how "good" of a saver she has been.

This is because a person can easily increase the sum of his or her deposits by depositing a single large sum towards the end of the year (which they can withdraw at any time), even though his or her earlier deposits throughout the year have been relatively small. This would not, however, have the same effect on the number of points. To obtain a large number of points, the large deposit would have had to been made earlier on in the year.

This is shown in the example below. Mr. B's and Ms. C's sum of deposits is identical, but Mr. C's points are higher, because he made a large deposit (100,000) at the beginning of the year, rather than at the end, like Ms. C.

No.	Name		1	2	3	4	5	6	7	8	9	10	11	12	Total
			9/03	10/03	11/03	12/03	01/04	02/04	03/04	04/04	05/04	06/04	07/04	08/04	
002	Mr. B	**1 (deposits)**	**100,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**210,000**
		2 (savings balance/points)	100,000	110,000	120,000	130,000	140,000	150,000	160,000	170,000	180,000	190,000	200,000	210,000	1,860,000
003	Ms. C	**1 (deposits)**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**10,000**	**100,000**	**210,000**
		2 (savings balance/points)	10,000	20,000	30,000	40,000	50,000	60,000	70,000	80,000	90,000	100,000	110,000	210,000	870,000

Because the village bank has a larger amount of money at its use during the year from Mr. B than from Ms. C, he is entitled to a larger share of the surplus.

Using the sum of points is therefore a fairer way of distributing surplus than using the sum of deposits.

How is savings interest calculated?

Once the points of all members are known, the savings interest that they each receive can be calculated.

The steps for calculating the savings interest are:

1. The **amount of money that will be paid out as savings interest to all members** is calculated:

First, the surplus of the village bank is found by subtracting annual expenses from annual income (see also section on the Income and Expenditure Statement in Chapter 7). For example, if a village bank's annual income is 14,115,000 Kip and its annual expenses are 7,597,000 Kip, its surplus will be:

14,115,000 Kip - 7,597,000 Kip = 6,518,000 Kip, since

Income – Expenses = Surplus

The surplus is then multiplied by the percentage that the village bank has decided will be paid out as savings interest to find out how much that amounts to. For example, if a village bank has decided that 70% of its surplus will be paid out as savings interest, the amount of money is found as follows:

Surplus × Percentage to be paid out as savings interest = Amount of money to be paid out as savings interest

Therefore, in this case: 6,518,000 Kip × 0.70 = 4,562,600 Kip

2. To find out **how much each individual member will receive** out of the total savings interest, the records of the members' points in the savings book are used and entered into the following equation:

Interest for Member X = (Points of Member X/Points of all members) × amount of money to be paid out as interest

If, for example, all of the village bank members' points add up to 214,000,000 Kip, the savings interest of Ms. A from the table below would be 33,182 Kip, since:

(1,560,000/214,000,000) × 4,562,600 Kip = 33,260 Kip

No.	Name		1	2	3	4	5	6	7	8	9	10	11	12	Total
			9/03	10/03	11/03	12/03	01/04	02/04	03/04	04/04	05/04	06/04	07/04	08/04	
001	Ms. A	1 (deposits)	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	20,000	240,000
		2 (savings balance)	**20,000**	**40,000**	**60,000**	**80,000**	**100,000**	**120,000**	**140,000**	**160,000**	**180,000**	**200,000**	**220,000**	**240,000**	**1,560,000**
002	Mr. B	1 (deposits)	100,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	210,000
		2 (savings balance)	**100,000**	**110,000**	**120,000**	**130,000**	**140,000**	**150,000**	**160,000**	**170,000**	**180,000**	**190,000**	**200,000**	**210,000**	**1,860,000**
003	Ms. C	1 (deposits)	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	100,000	210,000
		2 (savings balance)	**10,000**	**20,000**	**30,000**	**40,000**	**50,000**	**60,000**	**70,000**	**80,000**	**90,000**	**100,000**	**110,000**	**210,000**	**870,000**
Total of all 150 members		1 (deposits)													31,500,000
		2 (savings balance)													**214,000,000**

CHAPTER 9. MEASURING THE QUALITY OF THE LOAN PORTFOLIO

Giving out loans carries a risk: although most of the village bank members want to and in most cases do pay back the loans they take out, there is always a possibility that some loans will never be repaid.

It is important for the village bank to check from time to time how big this risk is (e.g. once every six months).

To assess this risk, the village bank can use indicators such as the "Portfolio at Risk" or the "Loan Loss Ratio", which are based on the loan repayment records of its members. To be able to check the quality of the portfolio, the village bank managers need to make sure that information on loans given out and repayments is up to date and available. This information should include:

- Total value and number of loans disbursed
- The number and value of loans outstanding
- Value of outstanding loan balances of loans with late payments
- Value of any loans written off (when a loan is so late that it is unlikely to ever be paid back, it is "written off" – i.e. is no longer considered as late but lost, and the loss is transferred to the income statement.

Risk and loss measures

❖ Portfolio at Risk

The **Portfolio at Risk** (PAR) indicator shows what percentage of the portfolio is at risk. The PAR measures the quality of the portfolio by comparing the outstanding balance of loans that are not being paid on time against the outstanding balance of total loans.

$$\text{Portfolio at Risk} = \frac{\text{outstanding balance of loans with overdue payment(s)}}{\text{total outstanding balance}}$$

Payments are usually considered overdue when they are over 30 days late, although there may be differences in the definition of lateness that different village banks use (see section 2 below).

The example below shows a calculation of the PAR.

Loans Given out by the Village Bank of Ban Phakka

No.	Name	No. of member	Date of loan	Contract No.	Activities	Loan amount	Loan period (month)	Interest rate (per month)	Payments (Kip)					SIGNA-TURE
									Date of payment	Loan	Repayment of loan capital	Interest payment	Out-standing balance	
1	Ms. A	02	1/1/08	01	Trade	200,000	6 months	3%	1/1/08	200,0000			200,000	
									1/2/08			6,000	200,000	
									1/3/08		50,000	6,000	150,000	
									1/4/08			4,500	150,000	
									1/5/08		50,000	4,500	100,000	
									1/6/08			3,000	100,000	
									1/7/08		?	?	?	
2	Mr. B	08	1/1/08	02	Retail	100,000	6 months	3%	1/1/08	100,000		3,000	100,000	
									1/2/08			3,000	100,000	
									1/3/08		No payment	3,000	100,000	
									1/4/08			3,000	100,000	
									1/5/08		No payment	3,000	100,000	
									1/6/08			3,000	100,000	
									1/7/08		?	?	?	
3	Ms. C	16	1/1/08	03	Pig raising	300,000	6 months	3%	1/1/08	300,000			300,000	
									1/2/08			9,000	300,000	
									1/3/08		100,000	9,000	200,000	
									1/4/08			6,000	200,000	
									1/5/08		100,000	6,000	100,000	
									1/6/08			3,000	100,000	
									1/7/08		?	?	?	
4	Ms. D	04	1/1/08	04	Open shop	400,000	6 months	3%	1/1/08	400,000			400,000	
									1/2/08			12,000	400,000	
									1/3/08		150,000	12,000	250,000	
									1/4/08			7,500	250,000	
									1/5/08		150,000	7,500	100,000	
									1/6/08			3,000	100,000	
									1/7/08		?	?	?	
5	Mr. E	23	1/1/08	05	Rice farming	200,000	6 months	3%	1/1/08	200,000			200,000	
									1/2/08			6,000	200,000	
									1/3/08		100,000	6,000	100,000	
									1/4/08			3,000	100,000	
									1/5/08		No payment	3,000	100,000	
									1/6/08			3,000	100,000	
									1/7/08		?	?	?	

In the village bank of Ban Phakka, five loans were disbursed on 1/1/08, and the loans were to be paid in three instalments. In June, the village bank committee decides to check how the loan takers are doing with their repayments. It appears that while all of the other loan takers have made their repayments on time, Mr. E missed his instalment in May and Mr. B missed his instalments in both March and May. The management committee uses the loan book to calculate the PAR:

The **outstanding balance of loans with late payments** on 1/6/08 is 200,000 (Mr. B and Mr. E have late payments and each of them have an outstanding balance of 100,000).

The **total outstanding balance** (sum of the outstanding balances of all the loan takers) on 1/6/08 is 500,000.

The **PAR** (outstanding balance of loans with late payments/total outstanding balance) is therefore 40%, since:

$$(200{,}000/500{,}000) \times 100 = \mathbf{40\%}$$

The PAR is based on the amounts that are at increased risk because of delinquency. Just because loans are late does not mean that they will never be paid back. A village bank can have a very high PAR (caused by a large number of late payments) but a very low loan loss rate (see below) if virtually all late loans are eventually paid back, as is the case in most village banks in Lao PDR.

However, if the percentage of the portfolio at risk is high, some special measures are needed to enable the village bank to cope with possible failures to repay.

If the PAR is over 5% at the time of surplus distribution, some of the surplus should be used to **form a reserve** for possible loan loss.

The amount of funds in the reserve should be equal to **20-25% of the outstanding balance of loans with late payments**.

In the case of Ban Phakka above, if the outstanding balance of loans with late payments would still be 200,000 at the time of surplus distribution, the amount in the reserve should be 50,000, since:

$$200{,}000 \times 0.25 = \mathbf{50{,}000}$$

This means that during surplus distribution, 50,000 Kip should be taken from the surplus and added to the capital of the village bank, rather than distributed as savings interest.

❖ Loan Loss Rate

To give an idea of how much may be lost through loans which are never paid back, it is useful to look at the PAR together with a measure of loan loss that the village bank has experienced in the past.

The **loan loss rate** shows what percentage of loans the village bank lost during a given period of time. This can be a useful indicator of how much the village bank can expect to lose in the future if conditions remain comparable.

The loan loss rate is calculated as follows:

$$\text{Loan Loss Rate} = \frac{\text{Total amount written off (over a given period)}}{\text{Average outstanding portfolio (for the same period)}}$$

The example below shows a calculation of the loan loss rate:

In June, the village bank of Ban Phakka decided to write off the loan of Mr. B. Out of the five loans given out, his was the only one written off. The management committee wants to find out what its loan loss rate during the period between January and June 2008 was.

The management committee checks* what the outstanding balance each month had been, and calculates the average from the figures below:

Month	January	February	March	April	May	June
Outstanding balance at the end of the month	1,200,000	1,200,000	800,000	800,000	500,000	500,000

The **average monthly outstanding balance** during that period is:

5,000,000/6 months = **833,333**

The loan loss rate is calculated by dividing the amount written off during between January and June (100,000) by the average outstanding balance during that period:

(100,000/833,333) × 100 = **12%**

* in this case, since only 5 loans are involved, the entries in the loan book can be used. In most real situations, village banks will have a far greater amount of loans, and it is easier to check the outstanding balances from the Ledger (see Chapter 7).

The loan loss rate should be **below 2%**. If it is higher, the village bank will not be able to continue operating unless measures are taken to improve repayment.

What factors affect these measures?

How accurate of a picture these measures give depends partly on the village bank's accounting policy.

When checking portfolio quality, the management committee should therefore take into account:

- **The way that late payments are defined**. Whether loans are classified as late and included in the above equation depends on the village bank's definition of lateness. Some commercial banks do not classify loans as late until they are 90 days past due, while some microfinance institutions classify loans as late one day after the payment was due. Using 30 days as the limit beyond which loans are classified as late works for most village banks. Once village banks are used to calculating these measures, they may want to make their assessment more precise by factoring in different **degrees of lateness**. Generally a loan which is 3 months late represents a greater risk than a loan which is one month late. Classifying late loans into different degrees of lateness and weighting them according to their relative risk when calculating the PAR helps to give a more accurate view of the risk.

- **Refinancing** (giving of another loan to finance the repayment of the initial loan) of loans that are not paid back on time. If loans are that are refinanced are not counted as late (even though they actually carry a higher risk than the initial loan) this makes the PAR lower than it should be and leads to an underestimation of risk. Refinancing should be avoided for this reason, but also because it can lead to a cycle of debt for the borrower.

- **Write-off policy**. When a loan is written off because it is unlikely to be repaid, this does not just affect the Loan Loss Ratio, but also the PAR. Since loans that are written off disappear from the PAR equation, a failure to write off loans which are unlikely to be repaid will lead to artificially high PAR. Similarly, if the write-off rate is very high, the PAR will be unrealistically low and risk will be underestimated.

PART 3
THE ROLE OF SUPPORT ORGANIZATIONS

CHAPTER 10. WHAT SUPPORT DO VILLAGE BANKS NEED AND WHO PROVIDES IT?

What support is needed by village banks?

Although village banks are owned and run by the members, in most cases some assistance is required for setting up the bank and, once it is operational, for ensuring that it can function smoothly.

The support needs of village banks vary, and are discussed in greater depth in the following chapter. In most cases, the support activities that are needed will include:

Setting-up Phase	• Awareness raising on the concept of village banking in the village • Technical support on group formation and for setting up the management structure, accounting system, rules and regulations • Training of the management committee
Operational Phase	• Technical support as needed, for example on record-keeping, savings interest distribution, or elections • Monitoring • Auditing • Special services: inter-lending (facilitating lending between village banks) and upgrading

Who supports village banks?

Often, more than one organization provides support to village banks. These may include for instance government departments, mass organizations, non-governmental organizations, microfinance institutions, and international organizations.

In the ILO village banking model, for example, in addition to the villages themselves, three organizations are involved:

- The ILO, which provides technical assistance on the village banking methodology to local implementers and initial loan funds to the villages
- The LCSDPA, which helps the villages to set up banks and provides training, auditing and other services to the village banks
- The local government, which supports the work of the LCSDPA in the villages

For the support that village banks receive to be as effective as possible, duplication among different organizations should be avoided and the strengths of each organization should be used.

This section gives an overview of the roles of different types of organizations involved.

❖ The Government

While specialized organizations (see below) will be needed to provide services directly to village banks, the government has an important role to play in the development of an enabling environment.

Among other things, the Government can help village banks and their support organizations by:

- providing a favourable regulatory framework on microfinance and banking
- maintaining macroeconomic stability
- avoiding interest rate caps which can make it difficult for microfinance providers to cover their costs

The Bank of Lao PDR has been working on a regulatory framework on microfinance, including village banking. Once the regulation enters into force, village bank committees will have to check whether their bank is in compliance with it, and whether any changes are needed.

❖ International development agencies

Because of their technical expertise in microfinance, international development agencies are often involved in the development of microfinance interventions such as village banking.

Their connections to the villages are usually not as close as those of locally-based organizations, and as their support is usually time-bound, their main role should be to support local partners who have a more active implementing role. This support may include, for instance, strategic guidance as well as technical and financial assistance to partners.

❖ Key Actors: Specialized support organizations

To ensure that village banks have continued access to good quality services, local, permanent, specialized support organizations are needed. Such an organization may be registered as a microfinance institution or as an NGO. To have a significant impact, it should:

- Have solid expertise in microfinance provision
- Be financially sustainable: the support organization needs to be able to operate without outside funding to make sure that it is in a position to continue providing support to village banks
- Be geographically close enough to the village banks it supports to reach out to them effectively.

The following two chapters relate to this type of support organization.

CHAPTER 11. SERVICES PROVIDED BY SPECIALIZED SUPPORT ORGANIZATIONS

This chapter gives an overview of the activities most commonly undertaken by specialized support organizations in the process of setting up and strengthening village banks once they are operational.

The needs of each individual village bank are different, and these needs should be taken into account during the planning of the organization's support strategy and activities.

1. Appraisal

The first step that a support organization needs to undertake is to identify villages where it will help to set up village banks. For the success of the village bank, it is especially important to decide:

1. What are the needs of the village in terms of financial services? What services to the village residents need and want (and are there differences between women and men's needs)? What services do they already use? Is a village bank the best response to their needs?

2. Will the support organization be able to continue working with the villages after initial set up? This is linked to both the capacity of the support organization in relation to the number of village selected, and to the characteristics of the villages, such as geographical remoteness.

2. Awareness-raising & group formation promotion

One of the first steps in setting up village banks is awareness-raising in the villages. As this involves consulting both the village authorities and the village residents, at least two initial visits are usually needed.

During awareness-raising, the future members and managers of the village banks are informed about the concept of village banking, the benefits of village banks and group formation, and what membership involves, as well as what steps will be needed to start it.

It is important that all potential members – both women and men, and the rich and the poor – are included in the discussions. This helps to ensure that they will have equal chances to participate and benefit later.

3. Setting up support: facilitating initial elections

The support organization will also need to explain the role of the management committee and the process of selecting its members. This should be done through elections by ballot. Usually five people will be elected to the committee. Encouraging village banks to hold separate elections for female and male candidates helps to make sure that women are also represented on the committee. See also Chapter 4 on the management structure.

4. Training

Once the members of the management committee have been elected, they need to be trained.

Training needs will vary depending on the participants and should be adapted to their needs, but **training topics** that need to be covered in most cases include:

- The concept and methodology of village banking
- Basics on village bank management
- Village bank rules
- Accounting (introduction to record-keeping tools and guidance on how to use them)
- Apart from technical/financial topics, initial training should also introduce the committees to issues which they will need to understand for the successful management of their banks, such as gender equality and the role of women in the village bank.

The **training methodology** needs to be suited to a low-literacy audience, which usually has little formal education. In the case of ethnic minority villages, language constraints and limited previous exposure to Lao culture need to be taken into account in the training design. In most situations, participatory training techniques which get the participants involved will work best. In many cases, women are less used to speaking up than men. Because of this, the trainers should make sure that there is equality between men and women in terms of the quality of participation – i.e. that they have equal voice and learning opportunities, regardless of their position in the village.

In terms of **logistics**, the support organization:

- Can reduce training costs by training the management committees of several villages at the same time. This is what the LCSDPA does: the members of the management committees of a number (usually 5) of village banks are invited to the same 3-day training at the district or provincial capital.
- Needs to provide **follow-up training** in the village. In many cases, difficulties will arise only once the trainees are back in the village, and these will need to be addressed so that the committee can perform its duties.

Apart from training which is linked to the operation of the village bank and which is mostly only given to the management committee, support organizations may wish to consider offering training (or linking the village to other providers of such training) to the village bank members in areas which strengthen their ability to make good use of the loans that they take. Training on business and financial management skills, in particular, is often needed. See Annex 11.1 for an overview of ILO training tools which have been tested and used in Lao PDR.

5. Monitoring and technical support

Regular monitoring of the village banks is needed to ensure that they do not run into difficulties and continue to work properly.

At the beginning, monitoring visits should take place frequently, e.g. on a monthly basis. Once the village banks have been running without problems for some months, the frequency of visits can be reduced.

Apart from standard checks, the support organization should be able to respond to the banks' demands for technical advice when needed. It is likely, for example, that support will be needed during the distribution of savings interest.

6. Auditing

An audit is a formal and independent review of the village bank's financial statements, records, transactions, and operations. Audits can be internal or external.

Audits (especially external ones) are important for the functioning of a village bank because they:

- Give assurance on the accuracy of financial statements to their members or other stakeholders, such as external loan givers
- Help to identify weaknesses in internal controls or systems, and prevent good-willed committee members from making accidental mistakes.
- Help to detect and prevent fraud and protect all members, especially – but not only – the ones who have put in savings, from the potential harm that could be inflicted by one or a few members or managers abusing the bank for their own interest
- May be obligatory for village banks in the near future based on the microfinance regulatory framework.

The scope of audits may differ somewhat. An audit can involve, for example, checking the following:

- Are each of the book-keeping tools filled in correctly?
- Do the amounts recorded in the different financial statements match?
- Are loan and savings regulations followed?
- Are interest rates calculated correctly?
- Are records on loans with late repayments kept systematically and are they accurate?

Audits are usually performed by **external auditors**. In some village banks an **internal auditing** committee complements this. Internal auditors have the advantage of being more familiar with the village bank and aware of operational problems than an external auditor would do. However, internal auditors cannot replace external auditors, who can examine the village bank with greater objectivity and independence, since they do not have personal relations with the village bank management or members. Because of their auditing experience, they will also have more technical expertise and skills than an internal audit committee.

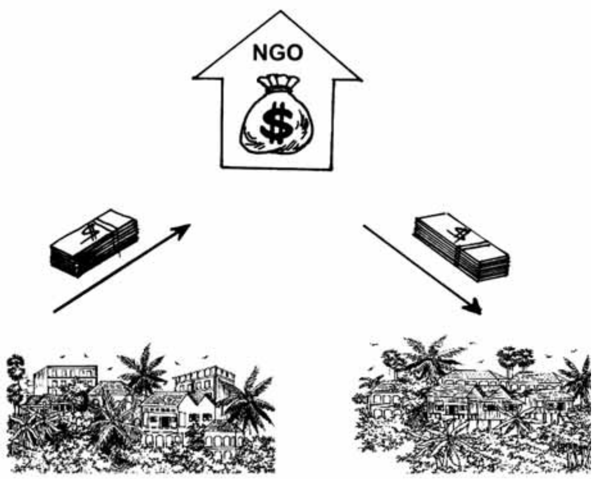
Audits do not have to be undertaken at the same frequency as general monitoring visits or informal reviews by the village bank's management: the LCSDPA, for example, audits the village banks that it supports **once a year**. This **service is paid** for by the village banks, who set aside 2% of their yearly surplus (with a cap of 1,000,000 Kip) for this purpose.

Key points which should be examined during the audit are given in the Checklist in Annex 11.2.

7. Beyond basic services: interlending & upgrading

❖ Interlending

In some countries, if their capacity is sufficient, in addition to these basic services, support organizations can also promote and facilitate **interlending between village banks**. Through interlending, a village bank which has an excess of funds can lend to other village banks which do not have enough funds.



Through interlending, one village bank can lend to another

To do this, the support organization can create a central 'interlending account', into which village banks can deposit excess funds, or from which they can borrow funds deposited by others.

A part of the interest on these transactions serves to keep the support organization running. The support organization sometimes also charges a fee for the service.

Interlending can:

- Give village banks an alternative way to deal with a lack or excess of funds: villages that need funds for productive purposes can access those funds, giving them the opportunity to improve livelihoods in the village, and at the same time generate interest revenue for the lending village.
- Strengthen the support organization's financial sustainability through the extra revenue it receives through the transactions.

In Lao PDR, there have not been many experiences of interlending[5]. Before interlending on a larger scale can be introduced, several steps need to be taken, including:

- The development of a regulatory framework to ensure that the money given by village banks for interlending is not mismanaged or put at risk.
- Capacity building of the organizations involved, given the complexity of setting up and operating interlending mechanisms.

❖ Upgrading

If the village banks' operations are sufficiently strong, the support organization may also encourage and facilitate their upgrading into a more formal entity, such as a **financial cooperative**. There are

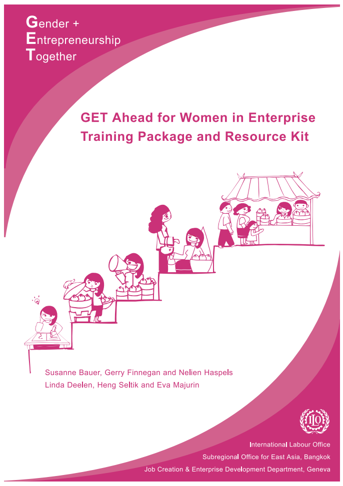
[5] The Lao-German Programme on Integrated Rural Development in Mountainous Areas of Northern Lao PDR (RDMA) has started facilitating interlending through its Community Credit and Saving Association in Sayaburi; apart from this, no information on other examples of interlending was available at the time of writing this handbook.

currently a number of large financial cooperatives in urban areas of Lao PDR. Financial cooperatives operate according to basic cooperative principles which include ownership of the cooperative by the members (and lack of external shareholders), with each member having one vote. Like in a village bank, the members can borrow and withdraw from the cooperative; in addition, they also hold shares which can be redeemed.

There is scope for village banks to transform themselves into financial cooperatives. This would require registration under the cooperative law. The management of financial cooperatives is often more complicated than in a village bank, and is best performed using a computerized system.

Annex 11.1. ILO Training Tools on Business and Financial Management

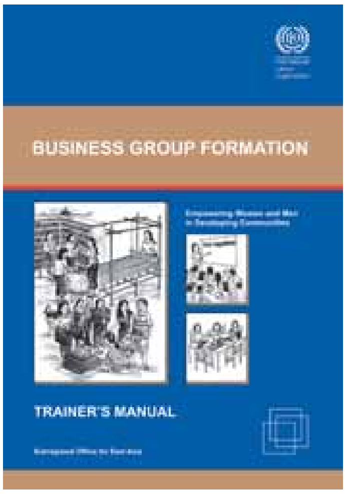
The ILO has developed several training programmes which have been used in villages where ILO supports village banks. These training programmes include:



GET Ahead for Women in Enterprise. The GET Ahead training package is targeted at women in poverty who want to start or are already engaged in small-scale business. The GET Ahead training package highlights essential entrepreneurial skills from a gender perspective. It addresses the practical and strategic needs of low-income women in enterprise by strengthening their basic business and people management skills. It shows women how to develop their personal entrepreneurial traits and obtain support through groups, networks and institutions dealing with enterprise development.

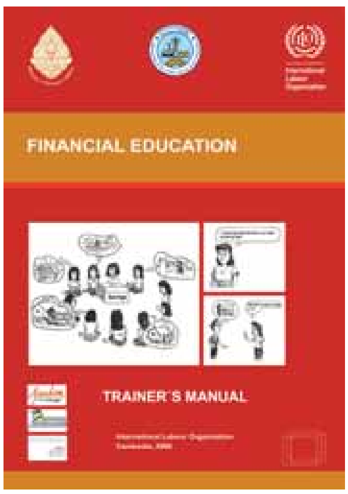
Start Your Business (SYB). The broad goal of the SYB programme is to help men and women who are thinking of setting up a business to start profitable and sustainable small businesses. The SYB programme materials consist of two sub-programmes:

1) SYB Business Awareness, which helps participants assess their readiness to start a business and the amount of money they have to start a business and to choose a business idea
2) SYB Business Planning, which teaches participants how to prepare a business plan, assess the viability of the business plan, and prepare an action plan for starting the business.



Business Group Formation (BGF). The BGF training programme aims to enhance the capacity of women and men in low-income communities to set up, manage and strengthen business groups. The training programme aims to improve the participants' understanding of the benefits and challenges of setting up a group, of the managerial and financial aspects of running a group, and of group dynamics, problem-solving, and mechanisms for working together effectively. The training programme puts strong emphasis on gender equality in business groups and particular attention is given to women's capacity to participate in and benefit from the programme alongside men.

Financial Education. This programme has been designed to provide women and men with basic skills related to earning, spending, budgeting, saving and borrowing to become more informed and empowered financial decision-makers, able to set financial targets and reach them. The Financial Education training programme covers topics such as: debt vs. equity finance, the dangers of over-indebtedness and default, comparing saving services, making a budget for the family, staying within a budget and making a savings plan.



These manuals are available from the ILO office in Bangkok and Vientiane.

Annex 11.2. Auditing & Monitoring Checklist

	Yes	No	Comments
General			
Are village bank rules adhered to?			
Has the village bank experienced any significant problems?			
Have there been any cases of fraud?			
Have there been any cases where money has gone missing?			
Management and institutional aspects			
Are elections of the management committee held regularly?			
Are elections of the management committee held by ballot (and not by hand-raising, for example)?			
Has the composition of the committees changed from previous years?			
Does the management committee perform the tasks outlined in the village bank rules?			
Does the advisory committee perform the tasks outlined in the village bank rules?			
Does the management committee regularly update the members on the status of the village bank?			
Are at least half of the village bank members women?			
Are at least half of the management committee members women?			
Do women attend general village bank meetings?			
Do women express their opinions during meetings?			
General record-keeping			
Are the record-keeping tools updated whenever transactions occur?			
Is each of basic the record-keeping tools filled in correctly?			
Loan Book			
Saving Book			
Cash book			
Ledger			
Are end-of-year financial statements prepared correctly?			
Do the amounts in each tool match the corresponding amounts in the other tools and financial statements?			
Are all record-keeping tools checked and signed by the persons responsible?			
Does the amount of cash on hand match the balance in the cash book?			

	Yes	No	Comments
Loans and savings administration			
Are the rules relating to giving out loans followed? (e.g. relating to maximum loan size)			
Is interest calculated correctly?			
Are failures to repay recorded?			
Are late payments monitored?			
Have any late loans been rescheduled? (i.e. by extending the loan term)			
Have any late loans been refinanced? (i.e. by giving out a new loan)			
Does the committee check the portfolio-at-risk regularly and correctly?			
Does the committee check its loan loss ratio regularly and correctly?			
Savings interest distribution			
Is savings interest distribution based on previously agreed shares?			
Is savings interest calculated correctly?			
Are payments made as they should be?			
Performance indicators			
What was the number of women and men members at the start?			
What is the number of women and men members now?			
How many members are under 18 years old?			
How many new members joined the village bank in the past year?			
What is the number of women and men management committee members?			
What is the number of women and men advisory committee members?			
What was the surplus (loss) of the village bank before the last savings interest distribution? (surplus = income – expenses, see Chapter 7)			
What was the active portfolio one year ago? (outstanding principal balance of all outstanding loans)			
What is the active portfolio now? (outstanding principal balance of all outstanding loans)			
What is the portfolio at risk? (outstanding balance of loans with overdue payments/total outstanding balance, see Chapter 9)			
What was the loan loss rate during the past year? (amount written off/average outstanding portfolio, see Chapter 9)			
What number of loans was given out to women? What number was given out to men?			

CHAPTER 12. FINANCIAL SUSTAINABILITY OF THE SUPPORT ORGANIZATION

What is financial sustainability?

To be able to continue providing services to village banks, the support organization must be financially sustainable. This means that it needs to be able to cover its costs without outside financial support, for example from a donor or from the government.

Costs which need to be taken into account are:

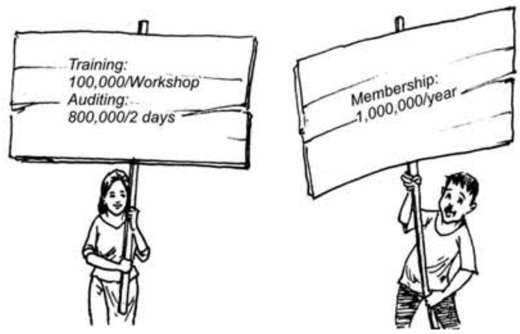
- **Basic operational costs**. To keep itself running, the support organization will need to pay for staff salaries, premises/office space, equipment, etc. Whatever additional costs arise out of each service provided must also be covered. This may include expenses such as transport costs or over-time payment for staff when the organization visits a village.
- **Cost of development**. If it wants to expand its activities or develop the services it provides, the support organization will need to make sure that resources for this are available after basic operational costs have been paid for. In other words, it needs to make surplus in order to grow.

Ensuring financial sustainability is important because the performance of the village banks which were set up with the help of the support organization depends on the continued provision of services by the organization.

What helps to guarantee financial sustainability?

To help make sure that it is financially sustainable, the support organization needs to:

1) Make sure it has enough income. At the beginning, some organizations provide some services for free, or at a subsidized rate. This can be a helpful – and sometimes necessary – step for helping to reach very poor people. However, it will only work for a limited amount of time, and only if the support organization itself receives financial assistance. This means that in the long run, the support organization will need to charge for its services. It can do this in a variety of ways:



- It can **charge for each service** on a pay-as-you-go basis. This means that the village banks which receive the service pay for what they get, and do not need to pay for services that they do not use. This can either take the form of a direct payment for the service, or, as in the case of interlending, a percentage of the surplus created through the transaction. Charging for each service rather than for membership means that there is a risk of reduced income in case of a drop in the demand for services. Because of this, charging per service is only recommended if the support organization has other income sources.

- If it is a member-based, permanent support structure, it can **charge for membership**, which will include the provision of services and other membership benefits. In this case, there are different payment mechanisms. For example, the support organization can have a membership fee (collected on a yearly or monthly basis), or it can agree with its member banks that they each give the support organization a percentage of their surplus. The village banks supported by the LCSDPA, for example, pay the association 2% of their yearly surplus.

2) Maximize internal efficiency. The support organization needs to minimize wastage of its income. To do this, its internal procedures need to be efficient, and service provision should be cost-effective. Simple steps can help to keep costs manageable: for example, visiting two neighbouring villages during the same day rather than in two separate visits will halve transport costs.

However, it is important to make sure that the reduction of costs does not affect the quality of services. This is because the extra costs caused by low-quality services can be far higher than the savings made initially. For example, training costs can be reduced by increasing the number of participants in each training or by cutting down on the training time. But if this means that the participants leave the training without having acquired all the necessary skills, the support organization will have to deal with these capacity gaps later.

3) Guarantee the village banks' satisfaction and good performance. As mentioned above, the village banks' financial contributions play a key role in the support organization's sustainability. The support organization therefore needs to make sure that the village banks are:

- **Willing to pay**: the services must be valuable and useful for the village banks. If this is not the case, their willingness to pay for the services or for their membership will decrease.
- **Able to pay**: if the performance of the village banks is negatively affected by management problems or repayment failures, the village banks may suffer such financial losses that they are unable to pay their membership fees, or the may not make any surplus.

Because of this, one of the main goals of the support organization should be to provide quality services – such as regular monitoring and technical support – which ensure good performance of the village banks it works with. See also Chapter 3 for more on ways of dealing with repayment problems.

ANNEX 1: GLOSSARY OF FINANCIAL TERMS

Audit – a formal and independent review of the village bank's financial statements, records, transactions, and operations. Audits can be internal or external.

Balance sheet – a financial statement which shows the net worth of the bank by summarizing the bank's assets, liabilities and equity. Village banks usually prepare balance sheets at the end of the financial year to show what their financial position at that point it.

Cash book – a book-keeping tool which shows all of the money that has come in (income) and gone out (expenditure) during each month.

Collateral – assets that are pledged to guarantee the repayment of a loan. This may include assets such as land or property or household appliances, small livestock or personal items like jewelry. Personal guarantors who will pay the loan in case the loan taker fails to do so are also used to guarantee the repayment of loans.

Declining balance – a way of calculating interest payments in which interest is only paid on the amount of loan capital that has not yet been paid back. The amount of interest therefore decreases with each instalment. This is the most commonly used way of determining the amount of interest. Another way, which is used less frequently, is the flat rate method, in which the amount of interest is calculated as percentage of the initial loan capital given to the loan taker, and stays the same throughout the loan period.

Default – when loan takers fail to pay back their loans. This is different from delinquency, which means that loan takers are late with their repayments.

Delinquency – when the loan takers do not make their repayments on time.

Disbursement – the transfer of the loan money from the village bank to the loan taker.

Income and expenditure statement – a financial statement which summarizes the income and expenditure of the village bank over the financial year, and is used for determining the net surplus or loss of the village bank.

Inflation – a rise in the general level of prices in a country. This means that fewer goods can be bought for the same amount of money as before inflation, and the cost of living rises.

Instalment –The regular periodic payment that loan takers make to the village bank to repay their loan. Usually the amount borrowed is paid back in several batches, rather than in one go – for example, if a village bank member takes out a loan of 300,000 Kip, this may be paid back in three instalments of 100,000, spaced out over the loan term.

Interest – the money paid by loan takers for using the village banks loan money. Whenever a loan is taken out, the loan itself must be paid back, but additionally, interest will also have to be paid. Some interest is usually paid each month. The amount paid is usually calculated as a percentage of the outstanding loan balance (see declining balance, above).

Interlending – lending and borrowing between village banks. Through interlending, village banks with an excess of funds can lend to village banks which lack funds.

Ledger – a book-keeping tool which shows income/expenditure by the type of item involved. For example, it shows how much was spent on external interest payments, or how much was earned from membership fees.

Loan book – a book-keeping tool which shows the details of all of the loans issued by the village bank. For each loan issued, it shows information on the loan taker, the amount, the loan term and interest rate, and details of interest payments and loan capital repayments made.

Loan loss rate – an indicator of portfolio quality which shows what percentage of loans the village bank lost during a given period of time. The loan loss rate compares the total amount written off over a given period and the average outstanding portfolio for the same period. Compare with portfolio at risk, below.

Loan term – the length of time (e.g. six months) for which a loan is given to a loan taker.

Nominal Interest Rate and Real Interest Rate – the nominal interest rate is the stated interest rate, which is what the borrower pays. The real interest rate takes into account inflation, which lowers the value of the interest that the village bank receives. The real interest rate is the nominal interest rate minus inflation.

Passbook – a booklet owned by each individual member which shows the details of his/her savings deposits and withdrawals and which is updated by the savings administrator.

Portfolio – the total of all the loans owed to the village bank by loan takers at a given time – i.e. all loans given out minus repayments. Loans with late repayments are included, but loans that have been written off are not. The portfolio only refers to the principal of the village bank's loans, not the interest that it receives on them.

Portfolio at Risk (PAR) – an indicator of portfolio quality which shows what percentage of the portfolio is at risk. The PAR measures the quality of the portfolio by comparing the outstanding balance of loans that are not being paid on time against the outstanding balance of total loans. Compare with Loan Loss Ratio, above.

Principal – the amount of money given to the loan taker. Loan takers must pay back the principal, but also interest.

Savings book – a book-keeping tool which shows the details of all of the members' savings records (i.e. dates and amounts of the deposits of each member).

Savings interest – the part of the village bank's surplus which is paid out to savers based on their savings record. Most commercial banks will pay savers monthly interest based on a fixed rate; in most village banks, the reward that savers receive is not based on a fixed rate, but on the amount of surplus that the village bank makes, and each member gets a share that is proportionate to the amount that he or she saved during the year.

Surplus – what is left over after expenses have been deducted from income.

The handbook on Village Banking in Lao PDR is a practical tool for strengthening village banks as a means of giving poor women and men in rural and often remote areas access to much needed financial services, social empowerment and a higher quality of life.

The handbook is based on the village banking methodology the ILO has implemented in Lao PRD in close collaboration with the Lao Community Sustainable Development Promotion Association. It explains what village banking is about and how village banks work, covering topics such as savings and loan policies, management, rules and regulations, gender equality and accounting. It explains the role of village bank support organizations or village bank associations and proposes financial sustainability strategies.

The handbook, which also exists in Lao language, will help Village Bank Management Committees to improve the operations and sustainability of their village bank. The ILO hopes that the handbook will help development organisations in Lao PDR to promote good practices in community-based microfinance.

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