

## CASE STUDY

# Transforming an NGO into a Commercial Bank to Expand Financial Services for the Microenterprises of Low-Income People – PRODEM and Banco Solidario (BancoSol) in Bolivia –

Yasushi KATSUMA

Ph.D. Candidate, Development Studies Program,  
Land Tenure Center,  
University of Wisconsin at Madison, USA

### Introduction

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### References

Efforts to expand access to financial services for microenterprises have been recognized as an effective strategy to enhance the economic activities of low-income people. The Grameen Bank in Bangladesh and Bank Rakyat Indonesia's Unit Desa (Village Unit) system are probably the most well-known "successful" examples of microenterprise finance programs operating in rural areas, each serving more than 2 million low-income people in a financially viable manner.<sup>1</sup> In Latin America, many of the non-governmental organizations (NGOs) that are currently active in this field were established after the rise of neo-liberal economic policies in the mid-1980s. These NGOs support "helping the poor help themselves" by providing small credit for the urban self-employed.

In 1992, in order to overcome some of the

constraints associated with being an NGO, the credit program of a Bolivian NGO was transferred to a newly established commercial bank named Banco Solidario, better-known as BancoSol, which specializes in microenterprise finance. As the first commercial bank to serve the microenterprises of low-income people, Banco Solidario offers a unique perspective. This paper examines the Bolivian microenterprise sector and financial markets, and explores Banco Solidario's replicability in Bolivia and other Latin American countries.

### I. Microenterprise Development as an Approach to Poverty Alleviation

Bolivia is one of the poorest countries in Latin America in terms of the annual income level. With an

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1. There are several articles on these institutions written in Japanese. For example, see the following: K. Fujita, "Bangladesh ni Okeru Tochi-nashi Hinkon-so heno Kinyu (Finance to the Landless Poor in Bangladesh)," *Asia Keizai* 31 (6-7), 1990. H. Yonekura, "Gendai Indonesia no Nogyo Kinkyu Mondai (Issues of Agricultural Finance in Contemporary Indonesia)," *Asia Keizai* 31 (6-7), 1990. T. Watanabe, "Tochi-nashi Hinkon-so no Senzai-ryoku wo Kaika (The Flourishing Potentials of the Landless Poor)," *Nyumon Shakai Kaihatsu* (Introduction to Social Development), Ed. Study Group on Social Development, Tokyo: International Development Journal, 1995.

average income per capita at 770 US dollars and the skewed distribution of its national income, the majority of the Bolivian population is considered to be living in poverty. The incidence of poverty is estimated at 86 percent in rural areas and 52.6 percent in urban areas.<sup>2</sup> Consequently, poverty alleviation is one of the most important development agendas for Bolivia.

In search of roles for development organizations in alleviating the poverty in Bolivia, several approaches have been recommended. The most popular approach to poverty alleviation taken by the government before the rise of neo-liberal economic policies was to keep the price of essential goods low by implementing regulatory policies. After that approach was abandoned in the mid-1980s, four other approaches became policy options for Bolivia: the welfare approach; the land reform approach; the human resource development approach; and the income-generation approach.

### 1. Approaches to Poverty Alleviation

The four policy options available to Bolivia are not mutually exclusive but rather complementary. However, they require different degrees of political coalition building for their actual implementation. The welfare approach to poverty alleviation does not threaten the interests of dominant groups, and therefore, does not stimulate political opposition. On the other hand, the land reform approach requires a strong political coalition in changing the existing endowment structure. There are also two other approaches, the human resource development and the income-generation approaches, which fall between these two opposite ends of a range.

The welfare approach to poverty alleviation consists of transferring income to targeted beneficiaries, such as subsistence farmers or certain ethnic groups, and providing safety nets for the economically disadvantaged. This approach can be implemented in the short-run, and does not require strong political coalition building, so long as additional taxes are not imposed on dominant groups. However, continuous assistance through this approach may not be financially feasible for governments suffering from budget deficits. In this respect, Bolivia is no exception. Nevertheless, Bolivia has managed to start creating some safety nets by implementing an innovative reform called "capitalization." This refers to establishing a pension system for the elderly by using newly available funds from the privatization of public enterprises.

The second approach is related to access to land. Land reform, including redistribution of land, is effective in alleviating poverty in rural areas. Land distribution is less skewed in Bolivia than in other Latin

American countries as a result of the land reform in the 1950s. This action made land available to 256 thousand households, or around 1 million people.<sup>3</sup> Nevertheless, access to land is still an important issue for the survival of many peasants today. However, large-scale land redistribution may not be politically feasible in the short-run in Bolivia where the political participation of peasants is meager. Alternatively, although it may not guarantee more accessibility to land for the poor, there is a national plan to activate the land market which has been stagnant due to the lack of clearly marked land ownership.<sup>4</sup>

The other two approaches, the human resource development approach and the income-generation approach, can be pursued as medium-term plans. The human resource development approach entails investing in basic education and primary health care programs. The income-generation approach involves fostering economic activities of low-income people. These medium-term approaches are intended to improve the opportunities of self-help for low-income people, while the first two approaches are aimed at redistributing wealth. These medium-term approaches to poverty alleviation are increasingly favored by development organizations because they tend to be politically feasible and economically justifiable as investments for economic development.

The human resource development approach to poverty alleviation focuses on investments in basic education and primary health by maximizing the outreach of basic social services. By emphasizing basic and primary levels of these services rather than higher education or sophisticated medicine, it is more likely that low-income people will be reached, and therefore, benefit through this approach. At present, it is not easy to justifiably oppose improvements in education and health for economic development. Even if the basic needs rationale is not sufficient to legitimate this approach, there are many research findings which indicate that East Asian investments in human resource development eventually pay off. Through this approach, cognitive and physical capacities of low-income people are empowered so that their participation in economic activities becomes more productive, resulting in more incomes for more people.

The income-generation approach deals with creating or strengthening institutions which will facilitate the economic activities of low-income people, given that the urban formal private sector is not absorbing the surplus labor drawn from the stagnant rural sector. There are roughly two levels of development organization that empower the economic capacities of low-income people: One is the grassroots

2. See United Nations Development Programme, *Human Development Report 1995*, New York: Oxford University, 1995, and World Bank, *Bolivia: Poverty Report*, Washington DC: World Bank, 1990.

3. See W.C. Thiesenhusen, *Broken Promises: Agrarian Reform and the Latin American Campesino*, Boulder, Colorado: Westview, 1995, pp. 51-68.

4. In June 1995, the World Bank decided to finance 20 million US dollars toward the implementation of the Land Management National Plan, which includes improvement of land registration. *Bolivian Times*, La Paz, Bolivia, June 16-23, 1995.

organization and the other is the grassroots support organization.<sup>5</sup>

Grassroots organizations are often called "people's organizations." They represent their members' interests, have member-accountable leadership, and are substantially self-reliant.<sup>6</sup> However, not all grassroots organizations are true people's organizations because some of them are dominated by elites.

Grassroots organizations can be classified into three major categories: Local development associations; interest associations; and pre-cooperatives and cooperatives.<sup>7</sup> Local development associations are multifunctional organizations engaged in community development. They often assume quasi-governmental powers in areas where local governments are lacking, such as squatter settlements and remote villages. Interest associations are formed based on either the sectoral needs of development or shared personal attributes, such as gender. The former type of interest association includes water user associations and pastoralist organizations, while the latter includes women's business groups and landless peasant organizations. Pre-cooperatives and cooperatives are membership organizations which pool the private resources of the members. Pre-cooperatives include work groups, rotating savings and credit associations, and borrower groups. Cooperatives include credit unions, consumer cooperatives, service cooperatives, and production cooperatives.

Grassroots support organizations assist the activities of grassroots organizations in communities other than their own. Even though they are usually staffed by paid professionals, grassroots support organizations are nonprofit organizations, while grassroots organizations may make profits. In Bolivia, the Foundation for the Development of the Microenterprise Sector (Fundación para la Promoción y Desarrollo de la Microempresa: PRODEM) was established as a grassroots support organization in 1986. The purpose of PRODEM is to provide credit for borrower groups consisting of low-income people who are engaged in microenterprises.<sup>8</sup> The provision of credit has enabled them to manage their very small businesses more efficiently. With credit, they can bulk purchase materials or merchandise at a discount. Also, manufacturers in particular can purchase materials and start another cycle of production without waiting for the proceeds from the sales.

The provision of credit is one way to facilitate the economic activities of low-income people, which will result in greater income for them. Whether credit is sufficient or not, it is often considered a necessary component of microenterprise development and is desperately needed where formal employment opportunities are limited. The provision of credit requires institution-building of both the grassroots support organization, which pools money provided by outsiders, and borrower's grassroots organizations. The effort involved in building these institutions is time-consuming. This is why it is considered a medium-term income-generation approach to poverty alleviation.

## 2. Microenterprises as a Way of Survival

According to the national census in 1992, 97.5 percent of the economically active population in Bolivia had some kind of job.<sup>9</sup> Although this figure suggests that the majority of people had some source of income, it does not necessarily mean that there were no employment problems. Since 1985, when structural adjustment programs were first launched, the composition of the Bolivian labor market has been significantly transformed. At the same time, employment in the public sector, including public enterprises, became drastically reduced and many people lost their jobs in the formal sector. Unable to find jobs in the formal private sector, most of the unemployed had no choice but to start their own small businesses in order to make a living. Consequently, the number of unregistered informal microenterprises, including the unregistered self-employed, multiplied. The share of informal jobs in urban areas increased from 25 percent in the early 1980s to 31 percent in 1986, and the number has not changed since then according to one study.<sup>10</sup> Another source reports that around 60 percent of the economically active population in urban areas and 90 percent in rural areas are engaged in economic activities in the informal sector.<sup>11</sup>

The economic activities of microenterprises are diverse. Perhaps the most visible to outsiders are the vendors. Many of them bulk purchase goods at a discount and retail them either on streets, at open markets, or in some cases, at their stores, while others are engaged in the wholesale trade. Other microenterprises include manufacturing businesses,

5. This distinction is drawn from J. Fisher, *The Road from Rio: Sustainable Development and the Nongovernmental Movement in the Third World*, Westport, Connecticut: Praeger, 1993.
6. D.C. Korten, *Getting to the 21st Century: Voluntary Action and the Global Agenda*, Metro Manila: Bookmark, 1990, pp. 100-102.
7. J. Fisher, *The Road from Rio: Sustainable Development and the Nongovernmental Movement in the Third World*, Westport, Connecticut: Praeger, 1993, pp. 36-47.
8. Microenterprise finance is an approach to poverty alleviation for people who can help themselves. In this sense, its scope is limited to an economically active population.
9. Instituto Latinoamericano de Investigaciones Sociales and Centro de Estudios para el Desarrollo Laboral y Agrario, *Informe Social Bolivia: Balance de Indicadores Sociales*, La Paz, Bolivia, 1994, p.36.
10. World Bank, *Bolivia: From Stabilization to Sustained Growth*, Washington DC: World Bank, 1991, p. 29.
11. PRODEM, *Organizational Profile*, La Paz, Bolivia, 1995.

such as apparel, textiles, furniture, candles, and musical instruments. Most are household industries. Other microenterprises provide services, such as cooking food at stalls and repairing shoes.

These microenterprises face a wide range of problems. For example, lack of capital, inappropriate technology, lack of management skills, insufficient basic education, and poor working conditions are often cited by outside observers. However, the most immediate concern expressed by microentrepreneurs is usually the lack of capital. They have very few opportunities to receive credit for financing the costs of operation, that is, bulk purchases of materials and merchandise, or new investments, such as sewing machines and circular saws. For the provision of credit, most of the formal financial institutions, including banks, set a minimum amount that can be taken out as a loan and require collateral to guarantee repayments. These financial institutions are rarely interested in lending money to microenterprises, which need only an average of 500 US dollars, and do not have sufficient collateral. Although informal lenders, such as relatives and friends, and a rotating savings and credit association called Pasanaku in Bolivia may offer small loans, their credit is not always available when needed.<sup>12</sup>

In the 1980s, the problems that microenterprises face became visible to policy makers as more and more people began to start their own small businesses as a means of survival. At this time, promotion of microenterprises became a policy issue in Bolivia. As a result, Bolivian grassroots support organizations, with assistance from European and North American NGOs, started to provide credit, training, and marketing support. In the late 1980s, the Micro and Small Enterprise Development Project was launched with assistance from the US Agency for International Development. This project was implemented from 1989 to 1993 by three Bolivian organizations: The Bolivian National Federation of Credit Unions (FENACRE), the Bolivian National Federation of Small and Micro Enterprises (FEBOP), and the Foundation for the Development of the Microenterprise Sector (PRODEM). Technical assistance was given to these three organizations by US-based NGOs. The World Council of Credit Unions in Wisconsin offered technical assistance to FENACRE and FEBOP, and ACCION International in Massachusetts offered assistance to PRODEM.

The small credit program of PRODEM was thriving at that time. Based on the successful operation of the credit program, a new commercial bank specializing in

microenterprise finance was established so that microenterprises could receive full financial services and the bank could access greater amounts of capital from local and international commercial sources. This bank is called Banco Solidario. In the following case, the success and limitations of PRODEM's credit program are analyzed, and then the reasons why the NGO decided to establish the commercial bank and transfer its credit program to the bank are discussed.

## II. PRODEM's Small Credit Program

As a non-profit foundation, or a grassroots support organization, PRODEM was established by Bolivian business leaders and ACCION International in 1986. For the purpose of providing small credit for microenterprises in Bolivia, business people contributed funds and demonstrated their leadership, and ACCION International provided technical assistance in the form of introducing a particular method of extending small loans. Initially, PRODEM was provided capital by the US Agency for International Development, Bolivia's Social Emergency Fund, the Canadian NGO Calmeadow in Toronto, and Bolivian private businesses. In 1990, the capital used for microenterprise financing reached 4 million US dollars, and PRODEM had assets that were equivalent to 2.1 million US dollars.<sup>13</sup>

### 1. Solidarity Group Lending

The methodology introduced by ACCION International is called "solidarity group lending." It is aimed at guaranteeing repayments from microenterprises which have insufficient collateral. Microentrepreneurs voluntarily form borrower groups, and the members of each borrower group become collectively responsible for other members' periodical installments. It is a joint liability system which is derived from traditional rotating savings and credit associations. In this way, a grassroots support organization can provide credit for the borrower groups of microenterprises in a financially viable manner.

There are three general characteristics of solidarity group lending methodology.<sup>14</sup> First, from three to ten microentrepreneurs form a borrower group. Second, the members of the borrower group become jointly liable for individual repayments, and agree that no member can receive another loan until all the members pay off their debts. Third, the amount, terms, and usage of credit are decided in accordance with the needs of the borrowers. These general rules are complemented by more specific guidelines appropriate to the needs of

12. Rotating savings and credit associations are a type of financial cooperative organized by mutually-reliable people. Periodically, whether weekly or monthly, all the members contribute a fixed amount of money to the group, and one member in turn receives all the money for his/her investments. The equivalent of Pasanaku is called either Tanomosi-kou or Mujin in Japan. These associations played an important role providing small loans to people in rural areas from the Medieval Period to the beginning of the Second World War. Some of them became more formal financial institutions.

13. PRODEM, *Informe Anual 1990*, La Paz, Bolivia, 1991.

14. S. Berenbach and D. Guzmán, *The Solidarity Group Experience Worldwide*, Cambridge, Massachusetts: ACCION International, 1992. p. 12.

each grassroots support organization.

In the case of PRODEM, borrower groups adhere to detailed guidelines.<sup>15</sup> The size of each borrower group should be between 4 to 7 microenterprises. All the members must already be proprietors of microenterprises. All the microenterprises of one borrower group must be located within a radius of three blocks. All the microenterprises must have been in operation for at least one year. All the members must be over 21 years old. There should not be any spouses or relatives within a single borrower group. In practice, as some microenterprises may have difficulty in forming a borrower group, not all of these guidelines are strictly adhered to as long as credit officers believe there will be no repayment problem.

Microentrepreneurs interested in obtaining credit are asked to visit their nearby PRODEM branch and participate in a briefing session in which the credit program, its procedures and rules are explained. Microentrepreneurs are then encouraged to form a borrower group with people whose businesses are in the same sector, such as commerce, manufacturing, or service. This is to ensure that all the microenterprises of one borrower group have similar capital turnover ratios, that is, so that they can agree on their common repayment terms and installment plan.

Once a borrower group is formed, and after deciding together on the name of the group and the group representative, all the members visit a particular credit officer who is assigned to their district. Each member fills out a personal information form and, as a group, they submit an application for credit. The credit officer visits each of their business locations to make sure that the information given on the form is correct. The officer then decides whether to accept the credit application. If the credit officer accepts the application, the form will be forwarded for appraisal to the credit committee consisting of all the credit officers at the PRODEM branch. Because the amount of first loans is very small, usually around 100 US dollars per person, most of the new credit applications are approved. However, future applications will be strictly assessed based on the group's credit history and payment capacity. By imposing strong discipline through the joint liability method, PRODEM manages to provide credit with high repayment rates for microenterprises without collateral.

If a credit application is approved, in the presence of all the group members, a contract is signed between PRODEM and the group representative, with other members as cosigners. Then a check for the total amount of the loan is issued to the group representative. The check is cashed at a cashier and the money divided so that a specific amount is allocated to each group member. The group representative is responsible for collecting money from all the members and paying the

monthly installments at the branch.

By making the group representatives responsible for scrutinizing the member selection process and monitoring the activities of their group members, PRODEM has shifted the costs associated with solving asymmetric information problems, such as adverse selection and moral hazard, away from itself to borrower groups. Adverse selection refers to the tendency that bad credit risks are the ones most likely to seek loans. Solving this adverse selection problem has become the responsibility of the group representatives. The problem of moral hazard refers to the risk of the borrowers engaging in activities that are undesirable from the lender's point of view. Consequently, the group representatives have become responsible for monitoring their own group members. By making the group representatives responsible for managing their own group members, PRODEM has become financially viable without asking for collateral.

## 2. Realistic Interest Rates

Expansion of the program can be brought about by setting realistic interest rates. The amount of money microenterprises need is very little. Even if they had collateral, no commercial banks would be willing to give a loan as small as 500 US dollars to microenterprises at the same interest rate as they lend to larger corporate borrowers. Since the costs of lending to a borrower are irrespective of the amounts of the credit, it is more profitable to lend larger amounts as long as the risk of moral hazard does not become too large. Therefore, using the same interest rate as ordinary commercial banks would not allow PRODEM to operate in a financially viable manner. To cover the relatively expensive costs of extending small credit, PRODEM has set a higher interest rate.

PRODEM's higher interest rate is often criticized by other welfare-oriented NGOs which offer credit at rates that are lower than commercial banks. It is argued that low-income people cannot afford high interest rates, and therefore credit programs should be subsidized. There seem to be at least three issues to be discussed regarding this argument.

First, PRODEM's credit program only reaches microenterprises that do not have access to other financial institutions offering lower interest rates, but whose profits are potentially higher than their interest payments. If PRODEM is able to lower its interest rate by reducing its transaction costs further in the future, other microenterprises which make less profits will be qualified to become borrowers. On the other hand, the credit programs of other NGOs which offer very low interest rates are attractive to *anyone*, including people who have no prospect of repayment and even higher-income people, as long as they can bear the cumbersome procedures. Therefore, "targeting" is an

15. Interviews with Roberto Capriles and Eduardo Bazoberry of PRODEM, La Paz, Bolivia, July 3, 1995.

important and difficult task necessary in selecting borrowers for these programs.

Second, in order to try to cover the cost of operation, PRODEM takes advantage of the spread between the interest rate it charges and the cost of procuring needed funds. Therefore, the credit program of PRODEM is becoming financially self-sustaining. On the other hand, credit programs with low interest rates do not cover the costs of operation so that an uninterrupted flow of charitable donations is necessary for the survival of the programs. In this sense, PRODEM's credit program is less dependent on external funding than programs with low interest rates.

Third, PRODEM can expand its operation by reinvesting its disposable income. In response to the growing credit demand by more and more microenterprises, PRODEM can establish new branches and hire additional credit officers to scale-up its operation. For other welfare-oriented NGOs, the microenterprises eligible to receive credit are limited both in number and geographical location by initial infrastructure investments, if additional donations for expansion are not readily available.

### 3. Limits of NGOs

The institutional development of PRODEM has been remarkable. After its credit program started in La Paz, the operation expanded to El Alto in 1988, Santa Cruz in 1990, and Cochabamba in 1991. In 1991, PRODEM had seven branches, and the number of professional staff increased to 116. At the end of 1991, PRODEM was serving more than 22 thousand microenterprises, and the amount of outstanding loans was more than 4.5 million US dollars. The arrears of more than 30 days were only 0.2 percent of the total.<sup>16</sup>

Despite its successful credit operation, the management staff and supporters of PRODEM began to observe some limitations of the program in the late 1980s. Although PRODEM sets realistic interest rates to become financially viable, it is still forced to face at least two limitations as an NGO. The first limitation is the lack of a savings function, and the second is related to its ability to procure funds. As a result of observed limitations, PRODEM was prompted to examine alternatives, including a change in its organizational structure from an NGO to a financial intermediary.

The first limitation of PRODEM is that NGOs are legally incapable of capturing savings in Bolivia. Although PRODEM utilizes the compulsory "savings" method in which 5 percent of the credit is set aside and not handed over to borrowers until the end of the loan term, it is not allowed to maintain voluntary savings.

This limitation gives rise to the following two problems. First, for microenterprises, savings is just as important as credit, and this cannot be made fully available to borrowers by an NGO. Not only microenterprises, but low-income people in general, have potentially great demands for savings services which would offer them a secure place to keep money and yield interest that would help offset inflation. As an NGO, PRODEM is incapable of offering such savings services to low-income people. Second, PRODEM is not allowed to capture savings which would be the least expensive way of procuring funds in order to offer loans. In order to expand its credit operation without this savings function, PRODEM has to ask for either subsidized loans or donations from foreign supporting organizations, which are often limited, or market-rate loans from other Bolivian financial institutions, which are always expensive. To date, PRODEM has been exclusively dependent on the former source of funding.

The second limitation of PRODEM is financial leverage. As an NGO, the amount of loans that PRODEM can obtain from other Bolivian private financial institutions will not ordinarily exceed the amount of its paid-up capital. Therefore, the total amount of the owned and borrowed funds available for the small credit program are at most twice as much as its paid-up capital. In this way, in order to reach the potential borrowers that are estimated at 500 thousand households in Bolivia,<sup>17</sup> PRODEM would need paid-up capital that is equivalent to half of the total loans demanded by the potential borrowers, which might be unrealistic. In short, PRODEM has difficulty in scaling-up its operation to the nationwide level.

In order to overcome the above limitations, PRODEM began to seek organizational change, that is, from a lending organization to a financial intermediary. By becoming a bank, the program can provide savings services for microenterprises. The savings services enable the program to procure the necessary funds for credit. They also diversify the sources of funding by allowing not only microenterprises but also larger private investors to establish savings accounts. Inter-bank deposits and central bank credit can also assist in diversifying funding sources. In addition, by coming under the supervision of the Bolivian banking superintendency (Superintendencia de Bancos y Entidades Financieras), through savings and loans, it becomes possible to procure funds of up to eleven times its paid-up capital. This ratio is based on the Basel Agreement which states that paid-up capital should not be less than 8 percent of the risk-weighted total assets. Therefore, the total funds available for a bank can be

16. A.J. Glosser, *BancoSol: A Private Commercial Bank*, Maryland: GEMINI, 1993, p.4.

17. An estimate by the office of the US Agency for International Development in Bolivia. This number is determined by subtracting 905 thousand households from the number of total Bolivian households. These 905 thousand households consist of 55 thousand households that already have access to commercial banks, 350 thousand that are clients of other financial institutions such as credit unions, 250 thousand for which credit cannot be provided in a financially viable manner because of geographical conditions, and 250 thousand whose incomes are too low to utilize credit. Interview with Stephan Smith of the US Agency for International Development, La Paz, Bolivia, July 11, 1995.

twelve times as much as its paid-up capital, resulting in more financial leverage.

In search of ways to transform its operation from a credit program to financial services, PRODEM established, in 1989, an independent organization named the Committee for the Promotion of the Bank for Microenterprises (Comité Promotor del Banco para la Microempresa: COBANCO).

### III. Transforming an NGO into a Commercial Bank

COBANCO was an organization that was created to transform the credit program of PRODEM into a commercial bank. Its activities began in four areas: undertaking financial feasibility studies; attracting investors; fulfilling required legal procedures; and planning operational transition.<sup>18</sup>

Four feasibility study reports were written before the final plan was adopted. Until the third report, it was assumed that subsidized loans or donations would be available from development assistance organizations. However, as a result of discussing the first three reports with international financial institutions and North American NGOs, COBANCO changed its policy from utilizing subsidized loans to procuring funds from local and international commercial sources. In short, instead of donations or subsidized loans, COBANCO was determined that the new commercial bank would mobilize financial resources by raising capital through equity sale to investors, including international financial institutions and development assistance organizations. Consequently, a parallel role was given to PRODEM. Only the operation of financially profitable branches would be transferred to the new commercial bank. PRODEM would remain a lending organization in areas where it would be difficult to be financially viable using market-rate loans, including semi-urban towns and rural areas. The fourth study adopted the above plan, and after some adjustment, the final study was completed in 1991.<sup>19</sup>

Of PRODEM's total assets of 5 million US dollars, it was decided the outstanding loans, equivalent to 2.5 million US dollars, would be sold to the new bank. In return, PRODEM would acquire equity of the same amount. As a result, PRODEM was initially to hold 44.2 percent of the total equity. The investments of Bolivian business people would account for a fourth of the total assets, and the rest would be held by foreign development organizations and NGOs. By December of 1990, 4.8 million US dollars in total were promised by investors, which would surpass the minimum requirement of 3.2 million US dollars of paid-up capital

for establishing a commercial bank.

Keeping in close contact with the Bolivian banking superintendency, the legal process for establishing a commercial bank was carried out. However, there were several obstacles to the process. First, since there were international and foreign assistance organizations among the investors, the Bolivian banking law of 1928, which was intended for domestic private investors, was not directly applicable to this case. It took time to build the consensus necessary to flexibly interpret the banking law. Second, since the new bank was going to guarantee repayments by microenterprises through the solidarity group system instead of traditional collateral, the appraisal by the Bolivian banking superintendency required deliberation. Finally, in February 1992, the new bank was authorized, owing to the successful operation of PRODEM and the persuasive efforts of some founders with wide banking experience.<sup>20</sup>

The transition of operation from a credit program to a bank providing financial services was organized in accordance with the rules of the Bolivian banking superintendency. The work to be completed before establishing a new bank included the specifications for reporting to the banking superintendency, the forms to be used for profit and loss accounts, the treatment of taxation, and the adoption of security measures.

The new bank was named Banco Solidario, meaning the solidarity bank. It is also known as BancoSol and uses the sun as its trademark. In February of 1992, Banco Solidario started its operations in the barrio of San Pedro in La Paz. As of 1996, a total of 33 branches have spread out in the cities of La Paz, El Alto, Cochabamba, Santa Cruz, and Oruro. The number of microenterprises currently served is 60 thousand, which is three times as many as the initial number in 1992. The share of women among the borrowers is currently around 70 percent. The outstanding credit totals more than 30 million US dollars.

At present, Banco Solidario offers financial services in urban areas, while PRODEM provides credit in semi-urban and rural areas. As branches of PRODEM in semi-urban areas become financially viable, they may possibly be transferred to Banco Solidario. In rural areas, it is difficult to provide credit in a financially viable manner due to low population density and lack of transportation infrastructure. Also, because of the high ratio of microenterprises related to agricultural activities, which are likely to be affected simultaneously by bad weather, it is difficult to diversify the credit risk. Therefore, the credit program in rural areas cannot stand on its own feet, and it is recommended by PRODEM that they be combined with the programs in urban or semi-urban areas.

18. A.J. Glosner, "The Creation of BancoSol in Bolivia," *The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*, Eds. M. Otero, et al, West Hartford, Connecticut: Kumarian, 1994, pp. 234-242.

19. Banco Solidario, *Proyecto de Factibilidad*, La Paz, Bolivia, 1991.

20. Initial private investors included Fernando Romero Moreno of Banco Hipotecario Nacional, Julio Leon Prado of Banco Industrial, and Gonzalo Sanchez de Lozada who was later elected President of Bolivia in 1993.

#### IV. The Financial Services of Banco Solidario and their Impact on Microenterprises

At the outset, Banco Solidario offered only two financial services: credit in the Bolivian currency, bolivianos,<sup>21</sup> and compulsory savings, both of which were inherited from PRODEM. Later, credit in US dollars was added as a service, and the function of voluntary savings was established, replacing the compulsory savings. According to the 1995 data, Banco Solidario was recognized as the most solvent and the second least risky bank among Bolivian commercial banks.<sup>22</sup>

##### 1. Credit Services

Banco Solidario conducts solidarity group lending in the same way as PRODEM. In Bolivia, solidarity group lending is considered to be "credit by guarantors" without holding collateral. Under the present banking regulation, the total credit by guarantors must not exceed twice the amount of the paid-up capital. This regulation could have set limits on Banco Solidario in expanding its credit operation without collateral. After negotiating with the banking superintendency, Banco Solidario was allowed to deduct loans of less than 2000 US dollars from this calculation.<sup>23</sup>

Loans are available in US dollars and bolivianos. Although the number of borrowers who receive loans in US dollars is only 40 percent of the total borrowers, these loans in US dollars amount to 60 percent of the total outstanding loans. It shows that a loan in US dollars is larger than a loan in bolivianos. In bolivianos, the monthly interest rate is 4 percent, with a one-time handling fee of 2.5 percent at the time of disbursement, resulting in an annual effective interest rate of 67 percent. On the other hand, in US dollars, the monthly interest rate is 2.5 percent, with a handling fee of 1 percent, which results in an annual effective interest rate of 34 percent.

There are several reasons for setting different interest rates for credit in bolivianos and US dollars. One reason is that the value of bolivianos depreciates about 10 percent annually against US dollars. Another reason is that a loan in US dollars is larger than a loan in bolivianos, which makes the costs of administering the credit in bolivianos relatively more expensive.<sup>24</sup>

However, the branches with more credit in US dollars tend to have less income generated from their lending program, suggesting that the difference in the interest rates might be too wide, given that the recent

foreign exchange rate has been relatively stable for Bolivia.<sup>25</sup>

As of 1996, for credit in US dollars, other commercial banks charge an annual interest rate of 18 percent. The interest rates of Banco Solidario are higher than this, reflecting the high costs involved in providing small loans for a large number of microenterprises. However, comparison is not easy because other commercial banks usually charge fixed-rate commissions for each installment. Although such commissions are negligible for large borrowers, they may be prohibitively costly for small borrowers, including microenterprises.

The initial amount of credit that Banco Solidario offers is usually between 100 and 150 US dollars. If all the members of a borrower group pay off their debts within the repayment term, they can increase the amount of their next loan. The credit history of the solidarity group is used to determine the creditworthiness of its members. Currently, the average amount of credit per borrower is around 500 US dollars.

The repayment term for borrower groups is usually between 12 and 24 weeks. For the first loan, the term is set at 12 weeks for microenterprises engaged in commerce or service, and 16 weeks for manufacturers. Installments are usually made weekly or biweekly by borrowers in the commerce and service sectors, and monthly by borrowers in manufacturing. The default rate is less than 1 percent of the total outstanding loans, due to the solidarity group lending method.

About half of the microenterprises which have received credit from Banco Solidario are in the commercial sector, and the manufacturing and the service sectors make up 30 percent and 20 percent, respectively. There are several reasons that explain the dominance of the commercial sector among the borrowers. First, from the outset, the commercial sector accounts for the majority of informal economic activities and is characterized by easy entry. Second, Banco Solidario has been focusing on the commercial sector by locating branches close to open markets. The microenterprises in the commercial sector are easily monitored because their installments are more frequent than other sectors due to the relatively high turnover ratio of capital.

##### 2. Savings Services

In August 1993, the compulsory savings service was replaced by new voluntary savings services. Three kinds of savings accounts have been established to serve the different needs of depositors: the Free Account

21. As of August 1996, 5.12 bolivianos were equivalent to 1 US dollar.

22. *Nueva Economía*, La Paz, Bolivia, April 30–May 6, 1996. 13 Bolivian banks were ranked using five financial indicators: profitability; solvency; liquidity; risk; and productivity. Banco Solidario ranked 8th in profitability, 1st in solvency, 6th in liquidity, 2nd in risklessness, and 13th in productivity, resulting in an overall ranking of 8th.

23. A. Agafonoff and D. Wilkins, *Developing Financial Instruments to Support Poverty-oriented Financial Institutions: Banco Solidario*, Chicago: Opportunity International, 1994, p.7.

24. Calmeadow, *An Overview of Banco Solidario SA*, Toronto, 1994.

25. I owe this observation to Gimena Cano of Banco Solidario's Cochabamba regional office.

(Cuenta Libre); the Capital Account (Cuenta Capital); and the term deposits.<sup>26</sup> The Free Account, offering a choice of bolivianos or US dollars, is a liquid deposit which allows unlimited transactions. Interest is paid monthly when the monthly average balance is more than 500 bolivianos or 100 US dollars. The interest rates are 15 percent in bolivianos and 6 percent in US dollars. The Capital Account allows only two withdrawals per month, but with higher semiannual interest rates. The interest rates in bolivianos are 14 percent when the monthly average balance is less than 500 bolivianos, and 18 percent when it is 500 bolivianos or more. The rates in US dollars are 4 percent and 8 percent, depending on whether the balance is less than 100 US dollars or more. Finally, the term deposits are only in US dollars and have a minimum deposit requirement of 200 US dollars, with a choice ranging between one month and twelve months. The interest rates are constantly adjusted in accordance with the market rates. As of August 1996, they were 8.3 percent for a month and 11.5 percent for twelve months.

Capturing savings is the least expensive way to procure funds for lending. However, the total amount of savings in Banco Solidario is still less than 20 percent of the amount of its total outstanding loans, forcing the bank to procure the difference elsewhere. Mobilizing savings is a difficult task in Bolivia. Although low-income people have a great potential demand for savings, they are afraid of putting their money in banks, due to bank failures in the past.

### 3. Tasks ahead for Banco Solidario

There are several tasks ahead for Banco Solidario. In the short-term, Banco Solidario needs to increase the profitability of its operations without resorting to raising its interest rates, which are already high. In the long-term, Banco Solidario needs to attract more investors so that its operations can be expanded more rapidly.

Although Banco Solidario charges higher interest rates than other commercial banks, some branches are not yet making a profit. As of June 1996, among the 33 branches of Banco Solidario, 13 branches were losing money. There seem to be at least two explanations.

First, although the average default rate for the whole bank is very low, defaults are experienced more at some branches than at others, many of which are located in Santa Cruz. According to several credit officers in Santa Cruz, the low-income people in Santa Cruz are used to being given "credit without repayment enforcement" by welfare-oriented NGOs, causing them to misunderstand the function of a loan. If this speculation is accurate, an appropriate strategy would be necessary to identify the microenterprises observing the rules. Also, training programs might be needed to

increase the current borrowers' awareness of repayment responsibility.

The second reason is the high costs of procuring funds for lending. Since the level of savings is low, in responding to growing demands for credit, Banco Solidario or the branches themselves often have to borrow from other commercial banks as a last resort. Therefore, capturing more savings is urgent. However, this may be a difficult task in Bolivia because people do not have much confidence in the banking system in general. My interviews in 1996 with randomly-sampled clients of a Banco Solidario branch in Cochabamba revealed that the great majority of them do not deposit their money in any bank. Particularly in Cochabamba, citizens have seen disasters induced by bank panics, such as the 1990 failure of FINSA (La Firma Integral de Servicios Arévalo), an unregulated financial institution called an "inmobiliaria".<sup>27</sup> The more recent failures of the Cochabamba Bank (Banco Cochabamba) and the Sur Bank (Banco Sur) in 1994 reminded them of the FINSA incident and reinforced their distrust in depositing their money in savings accounts. Restoring confidence in the banking system is indispensable, and may be too large a problem for Banco Solidario to solve itself.

In the long-term, Banco Solidario needs to attract more investors. The financial leverage was increased when PRODEM transferred its credit program to Banco Solidario. As a commercial bank, Banco Solidario is allowed to procure funds of up to twelve times as much as the amount of its paid-up capital in accordance with the Basel Agreement. Considering the paid-up capital of Banco Solidario, which surpassed 6.5 million US dollars in 1994, and the current outstanding loans of 30 million US dollars, in the short-run, there is still enough equity to respond to the growing demands for credit by microenterprises. However, in the long-run, in order to open up the micro-financial market further and reach the 500 thousand potential borrowers, it is necessary to attract additional investors.

### 4. Impact on Microenterprises

Banco Solidario has provided financial services for microenterprises which previously had no access to such credit and savings facilities. This task has been achieved in a financially viable manner without requiring collateral from low-income people. The number of microenterprises eligible to receive credit has increased dramatically since the organizational change from an NGO to a commercial bank. In this sense, the contribution of Banco Solidario to low-income people is significant, maximizing the outreach of microenterprise financial services.

Regarding the impact of Banco Solidario's financial services on the economic activities of microenterprises,

26. B. Calvin, "The Savings Service of BancoSol," *NEXUS* 28, 1995.

27. The aftermath of the bank failure is documented in the following book. Centro de Documentación, *Inmobiliarias: La Estafa del Siglo!*, La Paz, Bolivia, 1991.

there have been few systematic empirical inquiries. However, in theory, making credit accessible helps microenterprises. Credit enables them to manage their small businesses more efficiently. Credit allows them to bulk purchase materials or merchandise at a discount. Credit allows manufacturers in particular to start a new cycle of production without waiting for the proceeds from previous sales.

Although it is safe to assume that providing credit opportunities is a positive advancement, it is useful only for the microenterprises whose profits are higher than their interest payments. With the high interest rates of Banco Solidario, for which Bolivia's financial market is partially responsible, not all microenterprises can make profits by investing money borrowed from the bank. In order to reach the less dynamic strata of microenterprises, it would be necessary to lower the interest rates without jeopardizing the financial viability of the bank.

Among the microenterprises that can receive credit from Banco Solidario, there are some exceptionally successful cases. These success stories are often highlighted as evidence of the assumption that credit is the best solution. However, we should not romanticize the impact of credit by citing anecdotal examples. There is no panacea in the end. With or without credit, some proprietors of microenterprises are more entrepreneurial than others, due to their business talents, educational backgrounds, and prior job experiences. Although some management training would probably help the stagnant microenterprises move forward, it is not realistic to assume that all low-income people are potentially successful microentrepreneurs.

Another challenge to microenterprise development is to remove constraints to growth. Banco Solidario has certainly removed the barrier to financial services for some microenterprises. Nevertheless, there are other constraining factors, such as lack of vocational aptitude, inappropriate technology, lack of management skills, lack of market information, and inadequate infrastructure for business. All of these problems should be addressed so that microenterprises can grow from being a means of mere survival to being a nucleus of economic development. To remove these constraints to microenterprise development, a single organizational unit should not try to simultaneously solve several independent problems, each requiring a different approach. Rather, one organizational unit should focus on one specific aspect of development at a time, whether financial services or business training. Particularly, a credit program requiring the profit and

loss accounting system should be managed separately from other technical assistance programs.

## V. The Current Status of Micro-finance Programs and their Future Prospects

Although PRODEM and Banco Solidario are the focus of this paper, other credit programs run by NGOs in Bolivia are worth mentioning. In this section, the current status of other micro-finance programs in Bolivia will be examined, and how their experiences can be applied to other Latin American countries will be discussed.

### 1. Overview of Micro-finance Programs in Bolivia

Since the 1980s, when microenterprise promotion became part of the development agenda in Bolivia, many NGOs were established to provide credit, training, or technical assistance for microenterprises. These initiatives were assisted through funding from foreign development organizations and NGOs.

Besides Banco Solidario, there are NGOs providing credit for the microenterprises in urban areas. Some of these are CIDRE (Centro de Investigación y Desarrollo Regional), FIE (Centro de Fomento a Iniciativas Económicas), FUNBODEM (Fundación Boliviana para el Desarrollo de la Mujer), IDEPRO (Instituto para el Desarrollo de la Pequeña Unidad Productiva), PROA (Centro de Servicios Integrados para el Desarrollo Urbano), and the Pro-Credito Association.<sup>28</sup> ProMujer is a Grameen Bank replication supported by the Grameen Trust Foundation. There is also a consortium organization that functions as a center for the exchange of information about microenterprise development in urban areas, which is called CIPAME (Corporación de Instituciones Privadas de Apoyo a la Microempresa).

In rural areas, in addition to PRODEM, there are NGOs that administer credit programs, such as ANED (Asociación Nacional Ecuémica de Desarrollo), FADES (Fundación para Alternativas de Desarrollo), FONDECO (Fondo de Desarrollo Comunal), and the SARTAWI Foundation.<sup>29</sup> Similarly, there is a consortium institution called FINRURAL (Asociación de Instituciones Financieras para el Desarrollo Rural).

The lending methods of the urban and rural NGOs mentioned above are diverse.<sup>30</sup> While PRODEM and Banco Solidario emphasize the borrower groups, CIDRE, FIE, and Pro-Credito offer credit to individuals. For example, FIE provides credit for individuals who have guarantors, and sometimes enables individuals to

28. Interested readers should consult the following book. O. Berthoud and W. Milligan, *Sector Informal Urbano y Crédito*, La Paz, Bolivia, 1995.

29. See the following books. R.O. Marconi, *ONGs y Crédito Rural en Bolivia*, La Paz, Bolivia: Asociación de Instituciones Financieras para el Desarrollo Rural, 1996.

S. Wisniewski, *Mercados Financieros Rurales en Bolivia: Formas de Ahorro y Crédito y Demanda Potencial para Servicios Financieros*, La Paz, Bolivia: Fondo de Desarrollo Campesino (FDC), 1996. In addition, FDC publishes 4 thematic and 8 regional books on the Bolivian rural financial markets.

30. R. Casanovas and J. MacLean, *Acceso de la Pequeña y Microempresa al Sistema Financiero en Bolivia: Situación Actual y Perspectiva*, La Paz, Bolivia, 1994, p. 57.

use their sewing machines or telephone lines as collateral, if such items are available. Similarly, Pro-Credito lends money to individuals with either guarantors or collateral. However, in addition, it also functions as a pawn shop. On the other hand, IDEPRO offers credit to both groups and individuals. It is clear that solidarity group lending is not the only way to provide credit for microenterprises. The most important goal for any lending organization is to ensure that the credit is repaid by microenterprises. As a matter of fact, in 1995, Banco Solidario started lending to individuals who have had a good credit history for two to three years and can offer collateral.

In comparing the credit programs, differences can be found in the borrowers' economic activities. Although PRODEM and Banco Solidario support any economic activity, they tend to focus on the commercial sector. When a new branch is established, it is strategically located close to an open market in order to attract retailers who have higher capital turnover ratios. On the other hand, IDEPRO and FIE emphasize the manufacturing sector.<sup>31</sup> They are more concerned with the industrial structure of Bolivia, whose manufacturing sector has been hollowed out by the declining mining industry.

The sectors which the different programs focus on reflect their approaches to microenterprise development. The ultimate concern of PRODEM and Banco Solidario is the financial markets which have been, up till now, the exclusive playing fields of large corporations. Their goal is to reform the financial markets from which microenterprises have been frozen out, by establishing special financial intermediaries. For this purpose, the microenterprises in the commercial sector are more easily reached because they are more visible and densely located. On the other hand, IDEPRO and FIE take a more comprehensive approach to microenterprise development by providing vocational training, technical assistance, and marketing support, in addition to the provision of credit. For marketing support, FIE founded a trading company, ComFIE, which purchases the high-quality products of manufacturing microenterprises through a subcontract and sells them in Europe, the USA, Spain, and Mexico.<sup>32</sup> Although these comprehensive programs seem to be quite effective, the number of microenterprises which can participate is limited because of the high operation costs. To support the non-credit aspects of enterprise development, the Technical Assistance Service (Servicio de Asistencia Técnica), a public institution affiliated with the Secretariat of Industry and Commerce, recently started to offer matching-funds to-NGOs.

## 2. Transforming an NGO into a "Fondo Financiero Privado"

The establishment of Banco Solidario, the first commercial bank to specialize in microenterprise finance, has attracted a wide range of attention from all over the world. Particularly, the rapid expansion of its credit operation has made other NGOs recognize the advantages of commercial financial institutions based on the market mechanism. Consequently, the transition from PRODEM to Banco Solidario has become a model of transforming an NGO into a commercial bank.

However, for many NGOs, it is a very difficult task to procure 3.2 million US dollars of paid-up capital in order to establish a commercial bank. To lower the threshold of becoming a financial institution for these NGOs, negotiations were promoted in Bolivia by interested organizations, including the US Agency for International Development. As a result, Presidential Decree 24000 was signed in May 1995, and the financial system has been reformed to allow for a new type of financial institution specializing in microenterprise finance.<sup>33</sup>

The new type of financial institution is called the Private Financial Fund (Fondo Financiero Privado) which is under the supervision of the Bolivian banking superintendency. The amount of paid-up capital needed is 1 million US dollars which is significantly lower than the requirement for a commercial bank. Nevertheless, currently, there are not many NGOs which are capable of being transformed into a Private Financial Fund. In July 1995, the Pro-Credito Association, mentioned earlier, became a Private Financial Fund, and has changed its name to Los Andes.<sup>34</sup> Besides Pro-Credito, other NGOs, such as PRODEM, FIE, and SARTAWI, are said to be potentially capable of transforming into Private Financial Funds, according to their financial indicators. However, even though they will be capable of operating profitably, it will still be necessary to establish a framework to procure 1 million US dollars for their paid-up capital.

## 3. Frameworks for the Procurement of Equity

Supposing that there are 500 thousand households containing microenterprises in Bolivia and each microenterprise holds an outstanding loan of 500 US dollars, the total amount of funding needed for the micro-finance market would be 250 million US dollars. The total paid-up capital needed for procuring 250 million US dollars is about 21 million US dollars, dividing the amount of funds needed by a ratio of 12. At present, about half of the total paid-up capital needed is already present in the Bolivian micro-finance market. Therefore, at least 10.5 million US dollars of equity needs to be procured in order to reach the 500 thousand

31. Interview with Roberto Casanovas of IDEPRO, La Paz, Bolivia, July 6, 1995.

32. Interview with Ricardo Villavicencio Núñez of ComFIE, La Paz, Bolivia, July 11, 1995.

33. G. Sanchez de Lozada, *Decreto Supremo N. 24000*, Presidencia de la Republica, Bolivia, 1995.

34. Interview with Mery Solares de Valenzuela of Los Andes, La paz, Bolivia, July 5, 1995.

microenterprises.

The US Agency for International Development in Bolivia plans to assist microenterprise finance projects through North American NGOs.<sup>35</sup> First, it will provide funds for North American NGOs or a consortium of NGOs. Then, these organizations will invest equity in Bolivian NGOs so that they can become Private Financial Funds. This plan will be effective if experienced NGOs, such as ACCION International or Calmeadow, can directly participate as equity investors in the management of Private Financial Funds in Bolivia.

Besides the above plan, there is a multinational effort to promote micro- and small-enterprise finance in Latin America. The plan consists of investing in NGOs or financial institutions that specialize in financing micro and small enterprises in Latin America through the intermediary investment fund, ProFund in Costa Rica.<sup>36</sup> ProFund was established by a group of international funding organizations consisting of Multilateral Investment Fund, International Finance Corporation, governmental development assistance agencies, and North American and European NGOs. ProFund is an investment organization provided with funds from the above institutions. ProFund provides the equity for Latin American NGOs which are interested in converting to financial institutions, or for Latin American financial institutions, such as Banco Solidario, which might need additional paid-up capital for expansion. It is hoped that these frameworks for equity procurement will facilitate the improvement of the micro-finance markets in Latin American countries.

#### 4. Toward the Creation of Financial Institutions for Microenterprises

It is no accident that the first commercial bank for microenterprises was established in Bolivia. In a sense, COBANCO was fortunate because the minimum requirement of paid-up capital for establishing a commercial bank in Bolivia is 3.2 million US dollars, which is relatively less than in other Latin American countries. For example, in Columbia, the requirement is 15 million US dollars, which makes establishing a commercial bank more difficult.<sup>37</sup>

When establishing a new bank for microenterprises proves difficult, it may be more feasible to add a micro-finance division to an existing commercial bank. In Bolivia, the La Paz Bank has been experimenting with this new initiative. However, since the methodology of lending is significantly different from the traditional individual credit with collateral, it may be difficult to retrain credit officers. Therefore, it could

be more efficient to strengthen the NGOs which already have experience in microenterprise finance.

Another option is to transform an NGO into a non-bank financial institution. In some countries, it may make more sense to convert an NGO to a credit union. Alternatively, a new type of specialized financial institution, such as the Private Financial Funds in Bolivia, may be more effective in providing financial services for microenterprises.

### VI. Concluding Remarks

Because of its advantages in providing substantial financial services in a sustainable way, the financial intermediary approach has been attracting more and more attention in the field of microenterprise development. The transition from PRODEM to Banco Solidario shows how a commercial bank can better respond to the growing financial needs of the microenterprises of low-income people. However, establishing from scratch a commercial bank specializing in microenterprise finance can be very challenging. It was the remarkable achievements of PRODEM's credit program that persuaded the banking authorities of Bolivia to permit the unprecedented establishment of a commercial bank which provides credit without collateral. Also, the current successful operation of Banco Solidario owes a lot to the learning experiences of the staff who worked for PRODEM.

The provision of credit for microenterprises is an effective tool to empower the economic activities of low-income people. Many credit programs focus on access to financial services, and they tend to be evaluated by the number of credit disbursements and the default rates. However, the success of credit programs at the grassroots support organization level, where Banco Solidario exists, does not necessarily bring about the success of microenterprises at the grassroots organization level, where the borrowers struggle.

To support the development of microenterprises, it is important to examine how many constraining factors to growth have been removed. Although credit programs can remove the barrier to financial services, there are some other areas to be addressed, such as vocational aptitude, appropriate technology, management skills, market information, and adequate infrastructure for business. These problems must be solved so that microenterprises will be able to play active roles in economic development.

No single organizational unit should attempt to solve all of these problems because all-inclusive,

35. Interview with Stephan Smith of the US Agency for International Development, La Paz, Bolivia, July 11, 1995. The original plan schedules about 15 million US dollars for disbursement in the five years from 1995 to 2000. Procurement of equity, technical assistance to profitable credit programs, and assistance to the banking superintendent are included.

36. The size of the funding is planned to be 20 million US dollars. The North American and European NGOs include ACCION International, Calmeadow, FUNDES in Switzerland, and SIDI in France.

37. P. Mosley, *Metamorphosis from NGO to Commercial Bank: The Case of BancoSol in Bolivia*, University of Reading, Department of Economics, 1993, p.11.

comprehensive approaches often fail. Each challenge needs to be approached differently, using a different principle. In particular, credit programs, which require the profit and loss accounting system, should be managed separately from other technical assistance programs. In order to solve the interrelated problems that microenterprises face, organizational innovations will be necessary, such as coordinating several organizations that are engaged in different areas, or creating divisions within one organization that can pursue different approaches.

Regarding the methodology of lending, the borrower group method is not the only way to provide credit for microenterprises. The Bolivian credit programs offer loans to both groups and individuals. The most important goal for any lending organization is to ensure that the credit is repaid by the borrowers. In order to achieve this goal, different methods may be needed in different contexts in which lending organizations operate. The characteristics of microenterprises and their sectoral, regional, and national relations should be carefully studied so that an appropriate design can be formulated.

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