

# **The Evolution of Microfinance in Bolivia**

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Brown Bag Seminar  
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# WHY BOLIVIAN MICROFINANCE ?

## 1. BREADTH OF OUTREACH

- ▶ **RAPID GROWTH:** Amounts  
Numbers
- ▶ **SUBSTANTIAL DEEPENING:**  
% population  
% economic activity

but

- **URBAN-BIAS**
- **CREDIT-BIAS**
- **MISSION DRIFT ?**

# WHY BOLIVIAN MICROFINANCE ?

## 2. TRANSFORMATION AND REGULATION

- **EARLY EXPERIENCES (BancoSol)**
- **REGULATION FOLLOWS (dialectic)**
- **SPECIALIZED INTERMEDIARIES**  
(private financial funds: FFP)

## 3. COMPETITION AND SATURATION

- **INTRA-INDUSTRY**  
(group versus individual)
- **INTER-INDUSTRY**  
(consumption versus microfinance)

# WHY BOLIVIAN MICROFINANCE ?

## 4. SYSTEMIC RISK AND OVERINDEBTEDNESS

### ▶ ADVERSE SHOCKS

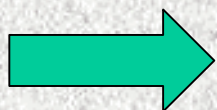
- RECESSION
- REGULATORY CHANGES
- POLITICAL INSTABILITY

### ▶ DIFFERENTIAL PERFORMANCE (institutional experiment)

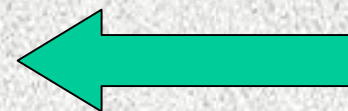
# APPROACH

## RECIPROCAL INTERACTIONS: (opportunities and threats)

### ▶ **MACROECONOMY** AND MICROFINANCE



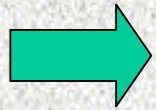
- economic growth
- monetary stability
- breadth of fluctuations over **cycle**  
(systemic risk)
- employment (**impact?**)
- distribution (**inclusion?**)



# APPROACH

## RECIPROCAL INTERACTIONS:

### ▶ **INSTITUTIONS** AND MICROFINANCE

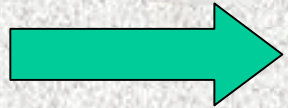


- prudential regulation
- prudential supervision
- credit bureaus

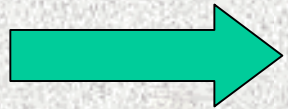


- contracts
- social capital: culture of repayment
- sustainable organizations

# JUSTIFICATION



One could not write the recent economic history of **Bolivia** without highlighting microfinance



One could not write the world history of **microfinance** without highlighting **Bolivia**

# The Macroeconomy and Microfinance

(1) Microfinance emerged  
after a macroeconomic crisis

...

and became possible only

→ after the *financial liberalization*

program that followed

(necessary condition)

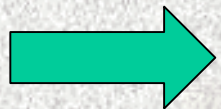
# BACKGROUND

## Microfinance emerged from the financial **crisis** of 1986-1987

- 1982-86**
- GDP dropped 3.4 % annually
  - public sector deficit > 30 % GDP
  - hyperinflation: 23,500 % annually
  - negative levels of international monetary reserves
- 1981-85**
- desintermediation:  
assets of financial system dropped from US\$ 1,000 million to a US\$ 60 million

# Microfinance was born out of the financial crisis of 1986-87

- a. Poor macroeconomic management
- b. State-owned financial intermediaries
- c. Absence of a prudential regulation and supervision framework



**EXTREME FINANCIAL REPRESSION**

# **BACKGROUND**

## **1. Financial Crisis 1986-1987**

### **a. Poor macroeconomic management**

- **unsustainable wage increases**
- **excessive public expenditures**
- **erosion of the tax base (avoidance)**
- **loss of access to external credit**
- **distorted exchange rates**
- **controlled negative interest rates**
- **high reserve requirements**
- **portfolio controls**

# **BACKGROUND**

## **1. Financial Crisis 1986-1987**

### **b. State-owned intermediaries**

- **incompetent management**
- **subsidized interest rates < costs**
- **politization and corruption**
- **poor risk management => default**
- **insolvency**
- **massive redistribution of wealth**

# **BACKGROUND**

## **1. Financial Crisis 1986-1987**

### **c. Absence of prudential regulation and supervision**

- ▶ **opportunistic private bankers**
  - **little capitalization  
(high leverage)**
  - **bailing out expectations**
  - **inside transacting (groups)**
  - **imprudent risk taking  
(moral hazard)**

# **BACKGROUND**

## **2. Stabilization Program 1985-1987**

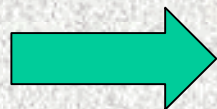
- halting inflation: 60 % in 1986  
(shock treatment) 14 % in 1987
- public sector deficit: 3.3 % GDP in 1986

## **3. Financial Liberalization**

- renewed intermediation:  
assets of financial sector:  
US\$ 315 million in 1986  
US\$ 560 million in 1987  
US\$ 659 million in 1988

# The Macroeconomy and Microfinance:

- (2) The initial features of microfinance were **responses** to the roots of the macroeconomic crisis

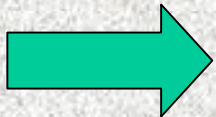


**LESSONS**

# BACKGROUND

- a. **Disenchantment with the *state-owned banks* as mechanisms to expand the frontier of financial services**

**opened up spaces for *private initiative*:**



- ▶ **first the NGOs**
- ▶ **next, other private intermediaries**

# PRIVATE VERSUS PUBLIC SUPPLY OF FINANCIAL SERVICES

- ▶ **credibility** of threats about contract enforcement
  - foreclosure on collateral
  - exclusion from future deals
- ▶ bureaucratic **incentives** for
  - diligent screening
  - forcefull loan collection
- ▶ fiscal sources of funds versus **deposit** mobilization

# PRIVATE VERSUS PUBLIC SUPPLY OF FINANCIAL SERVICES

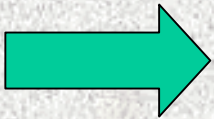
- ▶ expectations about loan **forgiveness** and creation of a culture of repayment
- ▶ vulnerability to **political** pressures in portfolio allocations
  - non-financial objectives (panacea)
  - rent-seeking
  - corruption
- ▶ unfair competition and institutional **crowding out**

# BACKGROUND

b. Failure of the **state-owned banks** as mechanisms to expand the frontier of financial services

promoted the evolution of the ***concept of credit*** :

- ▶ from a political (policy) tool
- ▶ to a ***contract*** that requires fulfillment [**social capital**]



# BACKGROUND

## c. The memory of *hyperinflation*

▶ destroyed *money illusion*:



actors learned to make  
computations in **real** terms,  
not in nominal terms

• acceptance of high **interest** rates  
(*perceptions of fairness*)

▶ allowed the development of  
transactions in both  
domestic and foreign currency  
(*protection of value*)

# BACKGROUND

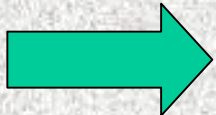
## d. The memory of *hyperinflation*

- ▶ strengthened **prudent** monetary and foreign exchange management by the **Central Bank** (**inflation** targets achieved at low rates)
- ▶ increased the **sensitivity** of depositors and other holders of financial assets to macroeconomic expectations

# BACKGROUND

## e. Liberalization of interest rates:

- made it possible to set interest rates at levels that allowed the MFOs to cover their operational costs  
(cost-covering rates)
- promoted innovation y adaptation of new financial technologies
- allowed realistic considerations about sustainability

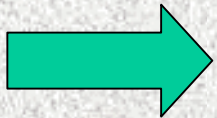


Operate on market terms

# BACKGROUND

## f. The weakening of **directed credit**:

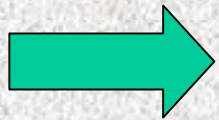
- made it possible to introduce the concept of the free use of the funds (*libre disponibilidad*) and to recognize fungibility
- allowed MFOs to concentrate their attention on the **riskiness** of the loans (ability and willingness to repay)



**Respond to demand and  
operate on market conditions**

# BACKGROUND

g. **Strengthening of the framework for prudential regulation and supervision:**



- restored **trust** in the financial sector

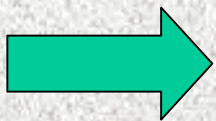
**but ... new financial crisis 1993-94**

- too rapid portfolio growth
- low capitalization of banks
- high portfolio concentration
- ownership weaknesses

# BACKGROUND

h. **Strengthening of the framework for prudential regulation and supervision:**

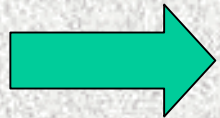
- ▶ allowed the creation of **BancoSol**
- ▶ allowed the development of a regulatory framework more appropriate for microfinance



**Fondos financieros privados (FFP)**  
**(Private financial funds)**

# BACKGROUND

- i. The **structural adjustment** program and the reduction in the size of the public sector resulted in the:

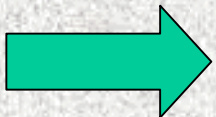


emergence of a large and dynamic ***urban informal sector***, not yet politicized, where an excess demand for financial services was not being met by the traditional banks

# BACKGROUND

j. The process of transformation attracted substantial amounts of **international assistance**:

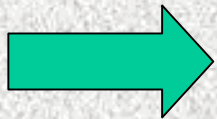
- ▶ the absence of state-owned banks prevented an initial massive channeling of loanable funds (avoidance of **crowding out**)
- ▶ groups of outstanding **innovators** used foreign assistance for **institution building**



# BACKGROUND

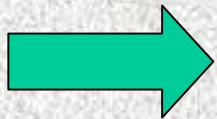
## Reasons for the initial success

### a. The vision:



- “*altruism with a business approach*”

### b. The method:

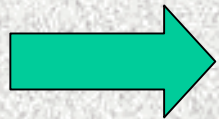


- **innovations** in lending technologies based on:
  - \* the value of the *relationship* with the client
  - \* non-traditional collateral

# BACKGROUND

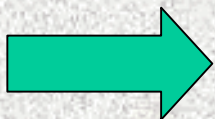
## Reasons for the initial success

### c. The actors:



- **leaders with clear vision and strong motivation**  
**FIE, PRODEM, ProCrédito**

### d. The environment:

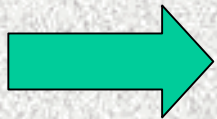


- **stable and rapidly growing market economy**

# BACKGROUND

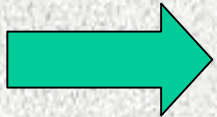
## Reasons for the initial success

### e. The externalities:



- strong **demonstration** effects
- **human capital** formation

### f. The links:



- contacts with internacional **networks**  
IPC  
ACCION

# BACKGROUND

## Transformation

**After rapid initial growth,  
most successful NGOs encountered  
severe constraints for further expansion**

- **dependence on foreign funds**
- **weaknesses of ownership**
- **organizational structure for growth**

**PRODEM → BancoSol**

**ProCrédito → Caja Los Andes**

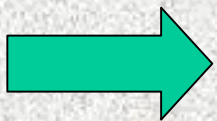
# BACKGROUND

## Transformation

- ▶ **Competitive disadvantages for non-regulated MFOs lead to transformation:**
  - **FIE FFP**
  - **EcoFuturo (IDEPRO, FADES, ANED, CIDRE)**
    - **PRODEM FFP**
- ▶ **Instances of success among**  
**non-regulated:**
  - **Pro Mujer**
  - **CRECER**
  - **FADES (?)**

# The Macroeconomy and Microfinance:

(3) The initial evolution of the microfinance sector (1987-1997), with rapid **expansion** of the breadth of outreach, was facilitated by a sound macroeconomic situation:

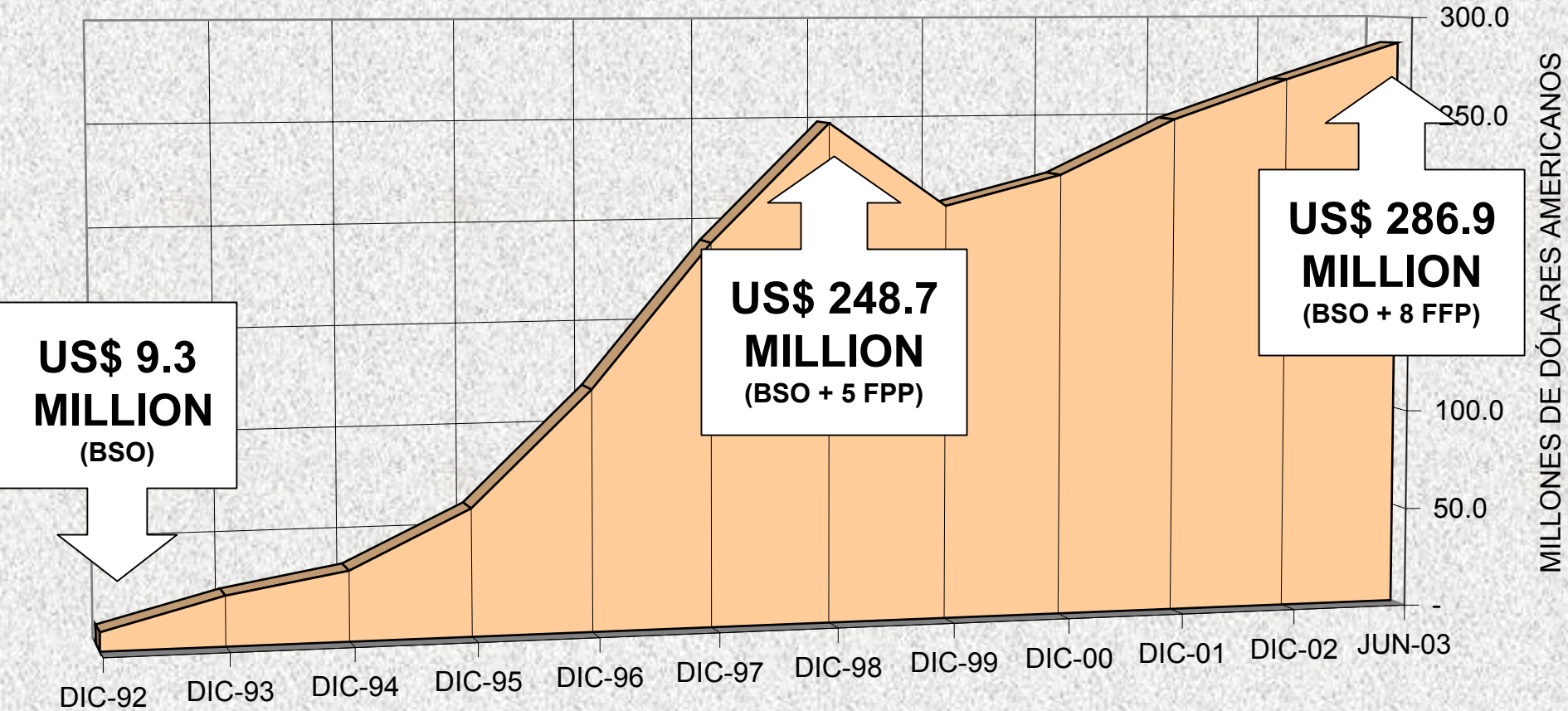


stable and rapid economic **growth**

# The Macroeconomy and Microfinance:

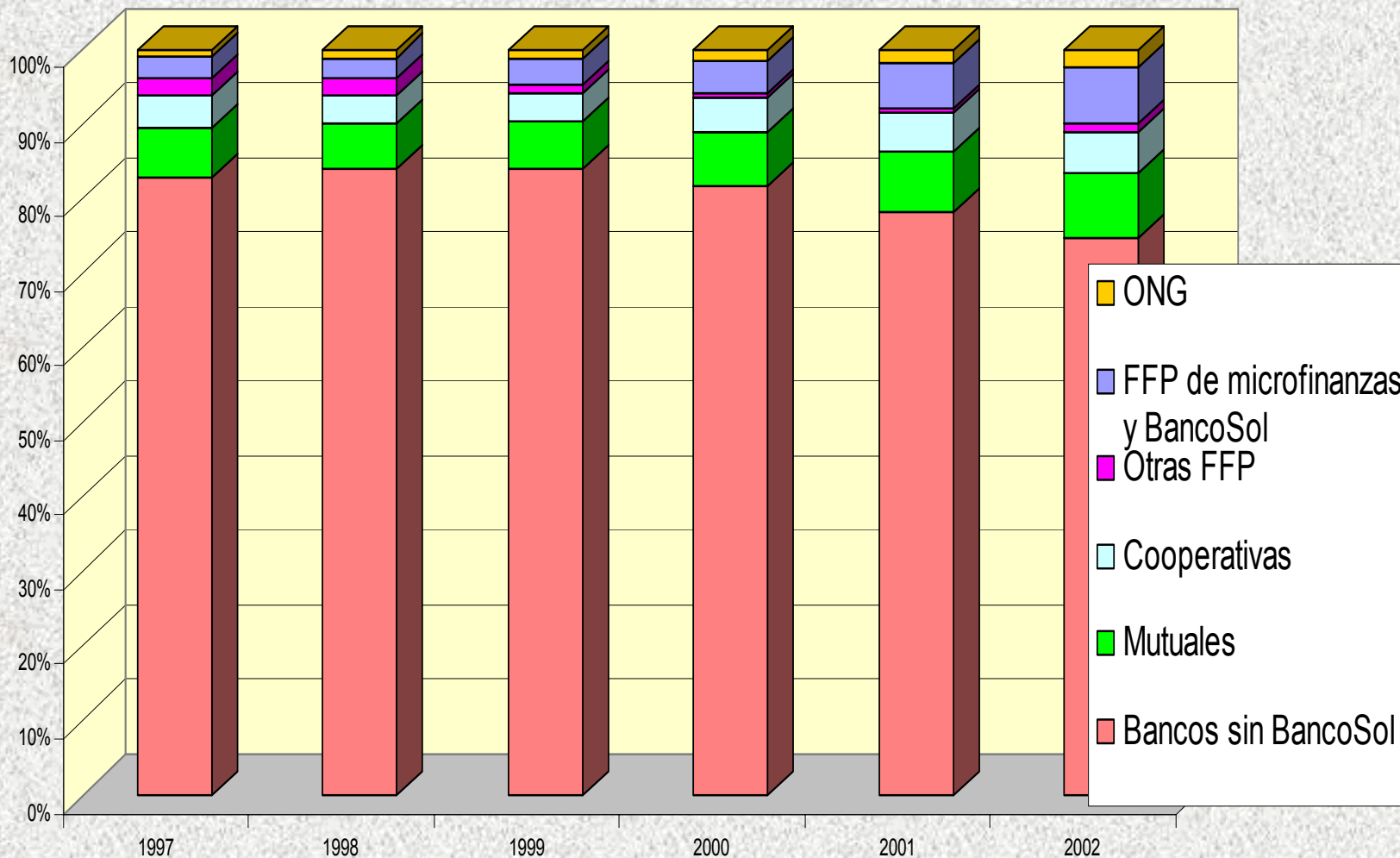
- ⇒ Rapid expansion of **portfolio** amounts
- ⇒ Rapid expansion of **numbers** of clients
- ⇒ Increasing market **shares** for MFOs
- ⇒ Financial deepening:
  - additionality** of clientele
  - depth** of outreach

# FFP + BANCOSOL: EVOLUTION GROSS PORTFOLIO OUTSTANDING



**Marcelo Villafani**

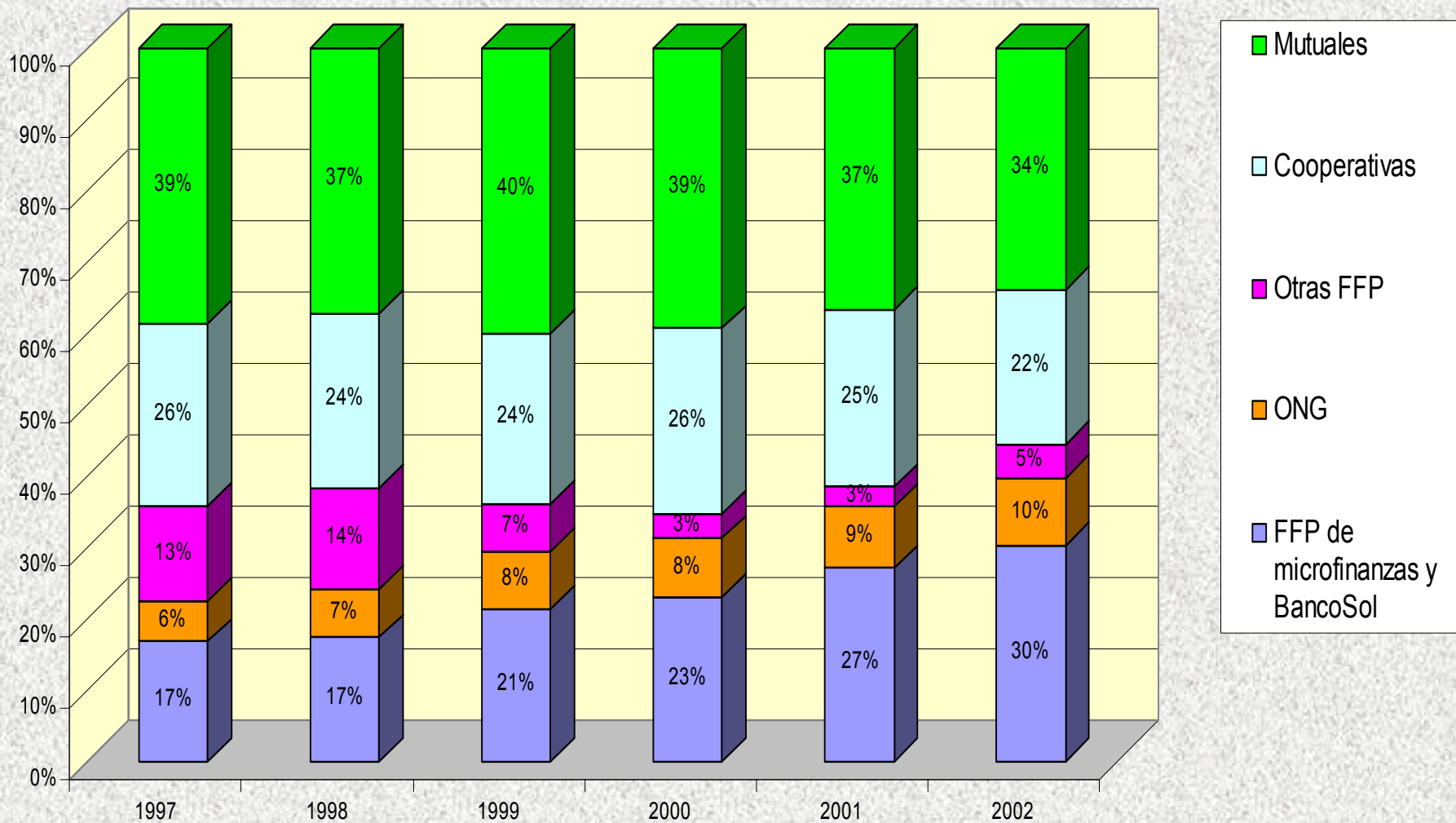
# Structure of the Bolivian Financial Sector's Portfolio



Fuente: SBEF y Finrural

**Jorge Rodriguez**

# Structure of the Bolivian non-bank financial sector's portfolio

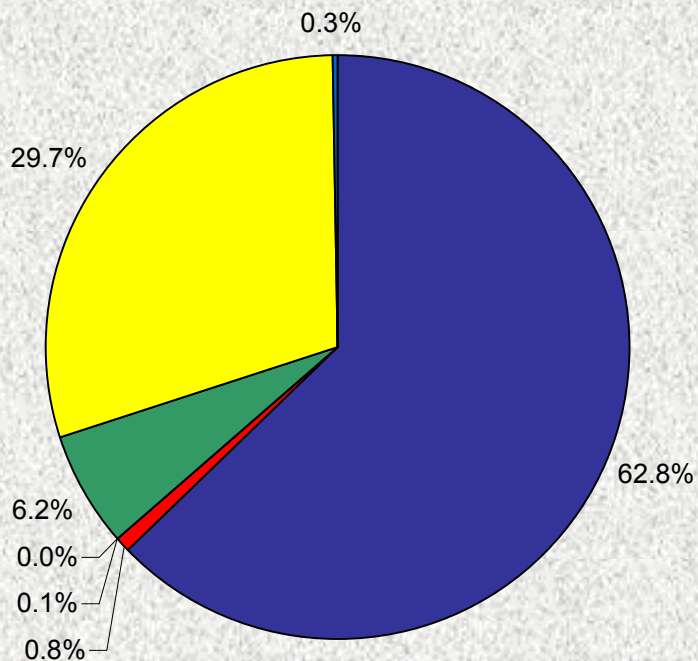


Fuente: SBEF y Finrural

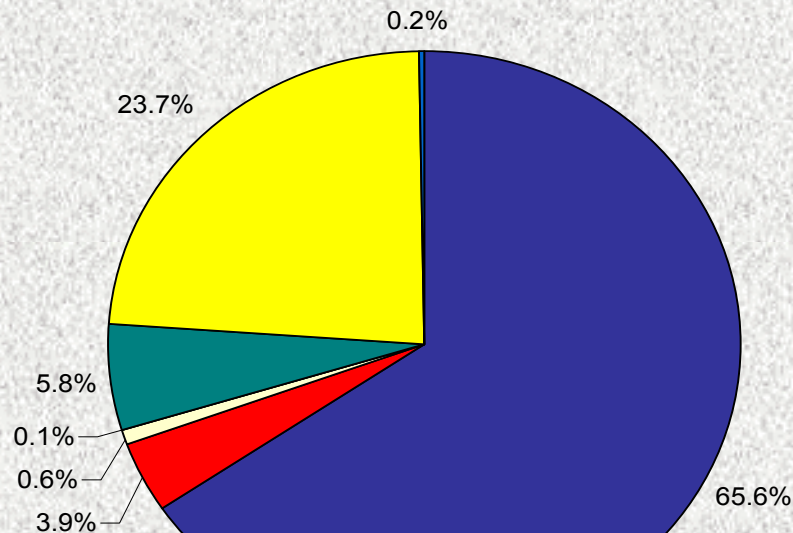
**Jorge Rodriguez**

# Shares in the Market for Passbook Savings Accounts

31.01.1997



30.06.2003

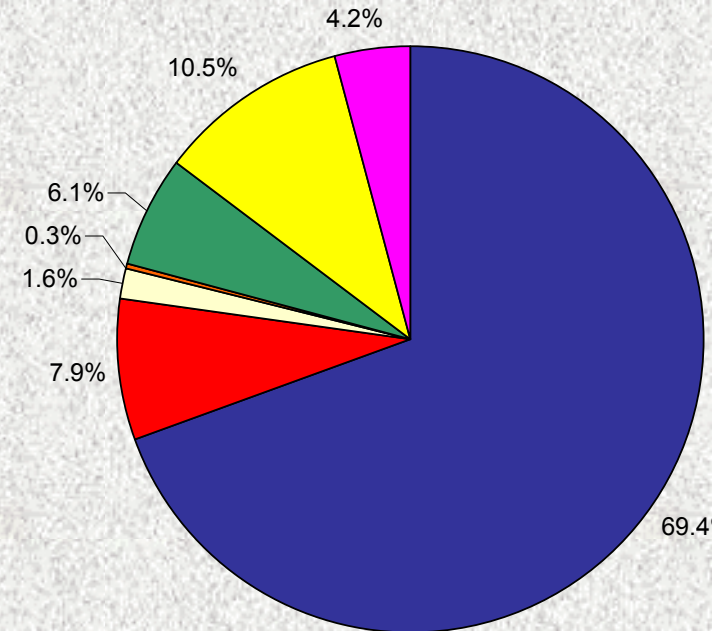
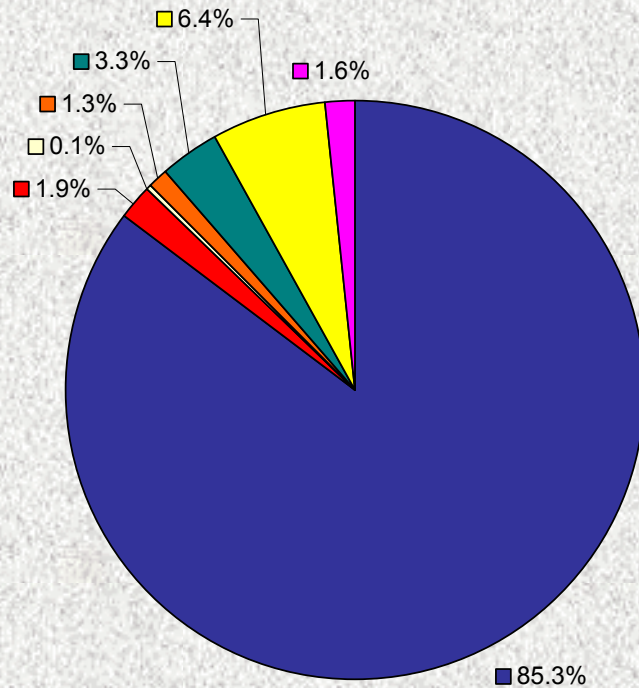


Franz Gomez

# Shares in the Market for Certificates of Deposit

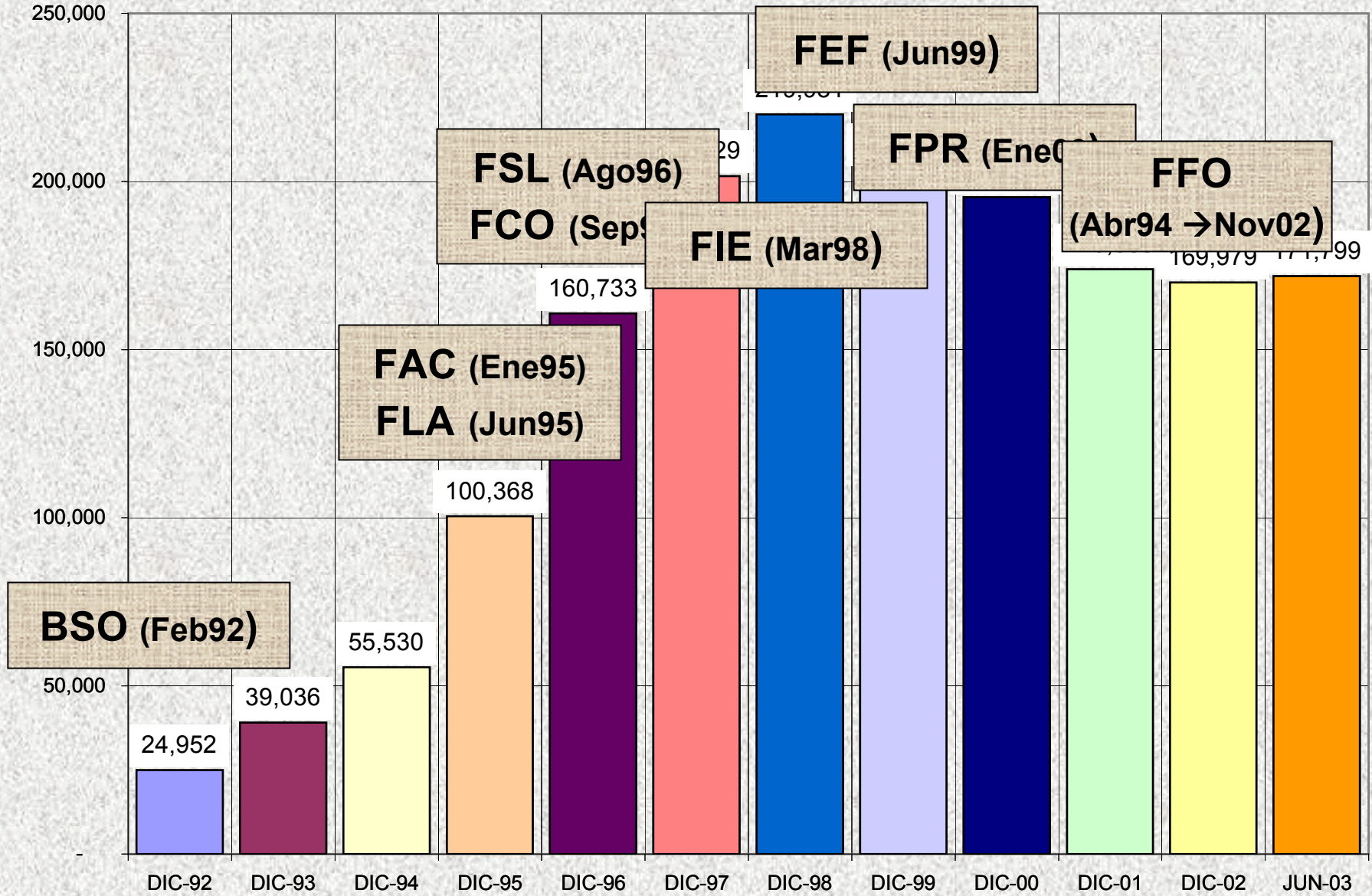
31.01.1997

30.06.2003



Franz Gomez

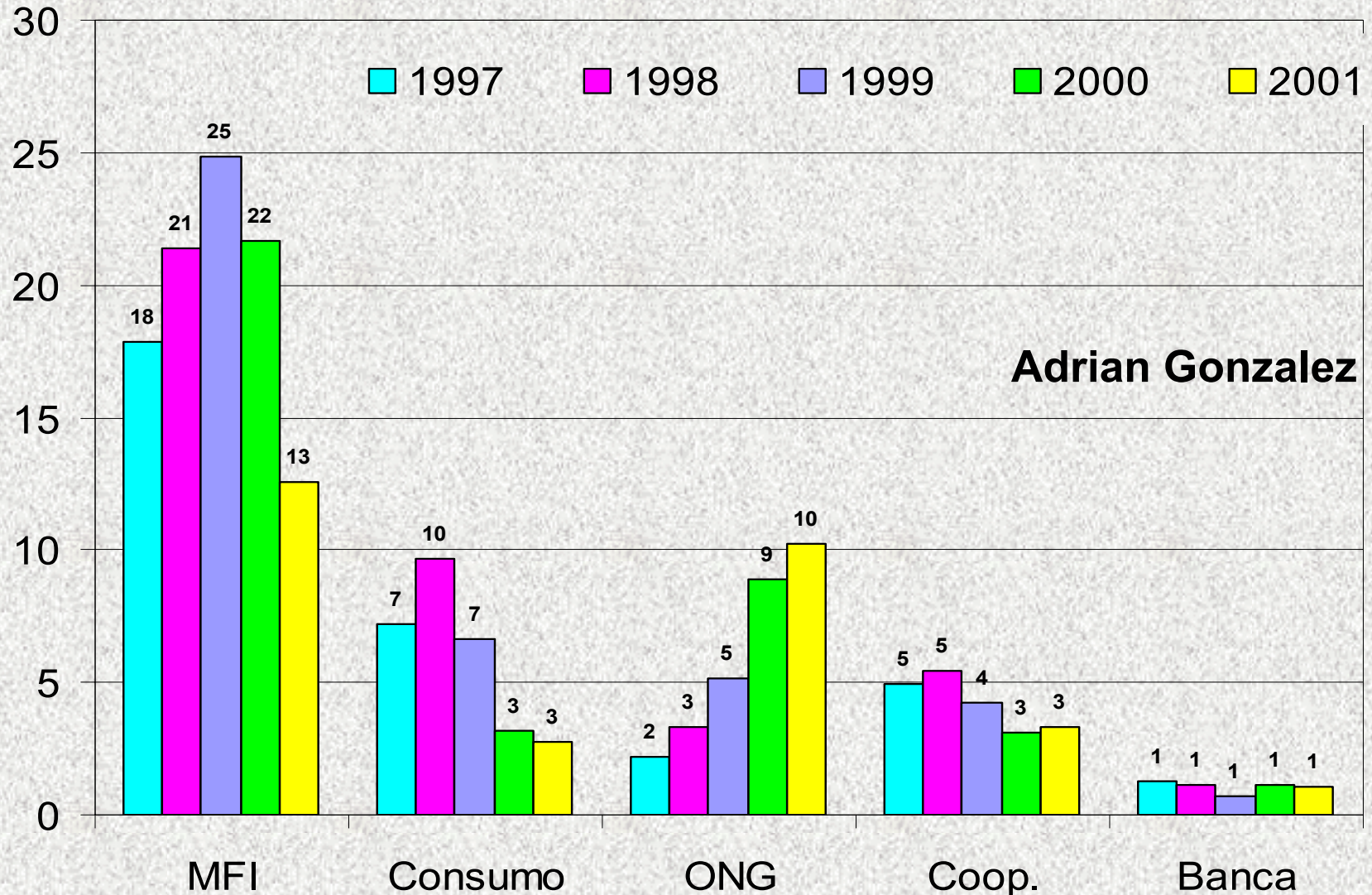
# Number of borrowers



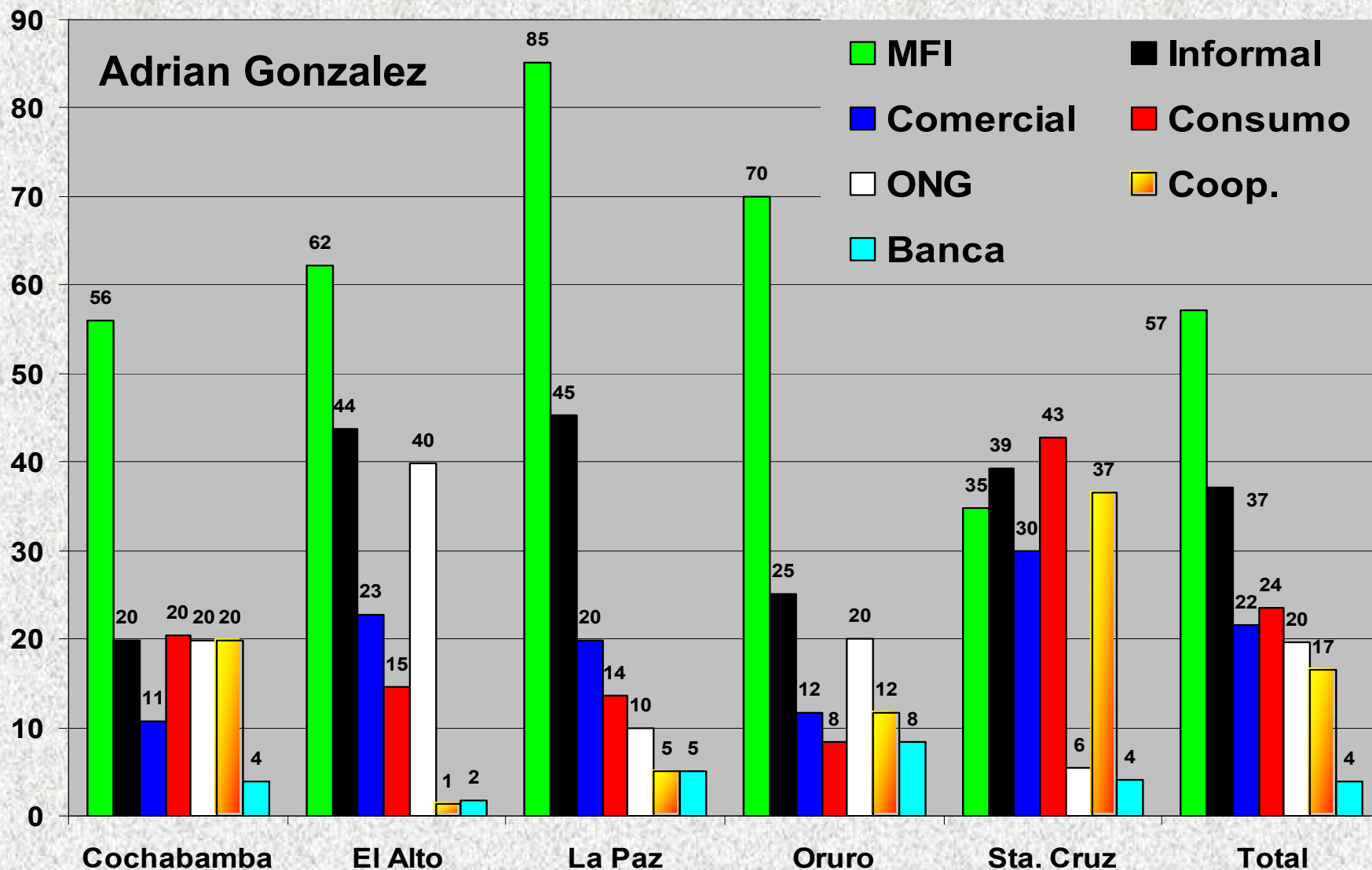
# **Market shares and financial deepening**

- ▶ **The specialized regulated microfinance organizations (BancoSol + FFP) have achieved the greatest breadth of outreach among clients in this segment.**
- ▶ **The importance of the outreach of cooperatives has been stagnant.**
- ▶ **The relative importance of NGOs has increased rapidly.**

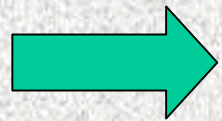
# Households with credit by type of source and year (% households)



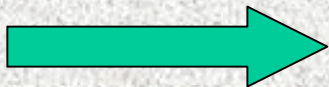
# Households with credit 1997-2001 by source and region (% clients)



**(3) The initial rapid expansion of the outreach of microfinance was facilitated by a stable macroeconomic situation:**



**the bulk of the innovations in microfinance technologies address *idiosyncratic risk*, not *systemic risk***



**sustained expansion stage through 1998 with little systemic risk**

**(4) Recent challenges and difficulties emerged from changes in macroeconomic trends:**

**(a) recession (crisis)**

**(b) following sharp increases in competition**

**... with similar and reinforcing effects**

# The macroeconomy matters

- a. Impacts on **confidence**: expectations
  - ▶ growth of deposits  
(financial deepening)
  
- b. Impacts on business **opportunities**
  - ▶ portfolio growth  
(demand and supply of credit)
  
- c. Impacts on **risk** (systemic):
  - ▶ increased default rates  
(liquidity and solvency)

# Similar Effects of Competition and the Recession

- **lower financial revenues ( $i * L$ )**
  - **smaller portfolio size ( $L$ )**
  - **lower effective interest rates ( $i$ )**
- **lower ability to dilute fixed costs ( $C/L$ )**
  - **smaller portfolio size ( $L$ )**
- **lower value of the client relationship**
  - **less willingness to repay**
- **lower ability to repay of the clients**
- **less opportunities for portfolio diversification**
  - **systemic risk**

# Similar Effects of Competition and the Recession

- **higher average transaction costs for borrowers**  
→ **smaller loan sizes**
- **higher average administrative costs of lending**
- **higher costs of reserves and provisioning**
- **lower profits: less value of the charter:**  
**moral hazard**
- **lower costs of funds**  
→ **perceptions of fairness**

# DIMENSIONS of CRISIS in BOLIVIA

## ▶ *macroeconomic crisis*

roots mostly exogenous to the country:  
→ unavoidable international contagion

## ▶ *financial crisis*

roots mostly exogenous to the financial system:

→ stagnation of the economy

→ weaknesses of the political system

## ▶ *endogenous* institucional deficiencies :

→ poor portfolio quality

# MACROECONOMIC CRISIS

- (a) Rapid expansion followed by slowdown (*cycle*)
- (b) Internacional **contagion**
  - terms-of-trade deterioration
  - fall of exports and imports with world recession
  - defensive devaluation without inflation
  - Dutch disease ?
- (c) Risk of **regulatory change**
  - Ley de Aduanas (customs regulations)
  - coca eradication
- (d) Weakness of **political system**
  - road blockades, marches
  - fragmentation and governance challenges

# MACROECONOMIC CRISIS

## (e) Financial **disintermediation**

- Reduction in deposit mobilization  
(real terms)
- Reduction in outstanding portfolios  
(real terms)
- Increase in default rates
  - less ability to repay
  - less willingness to repay
- private capital outflows

# MACROECONOMIC CRISIS IN BOLIVIA

## Expansion followed by deceleration

- ***Economic expansions followed by the deceleration of growth cause grave problems in financial systems***
- **The serious problem is not the recession; the problem is the *cycle***
  - \* **low rate of growth, *small* financial system**
  - \* **volatile rate of growth, financial system *in crisis***

# FINANCIAL CRISIS

***Differential impact*** of adverse macroeconomic shocks on financial intermediaries =  $f(\cdot)$

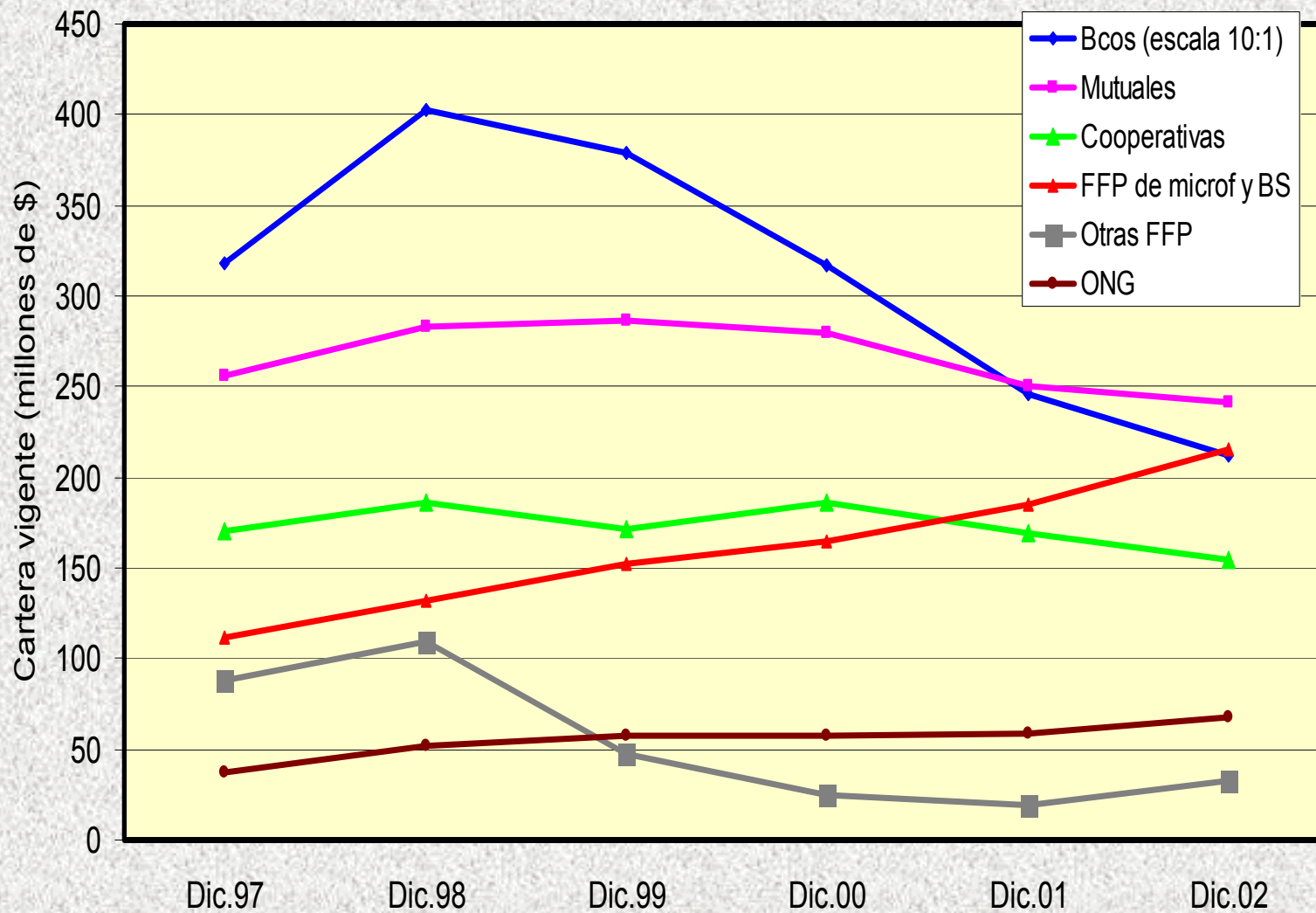
- (1) degrees of ***idiosyncratic vulnerability***
  - ▶ non-uniform incidence and magnitude of shocks
- (2) **institucional and technological features**
  - ▶ institutional strengths
    - ability to forecast and to adjust
  - ▶ versatility of the technology
- (3) **asymmetric support**
  - ▶ ignores institutional idiosyncracies

# LESSONS FROM FINANCIAL CRISIS

1. ► the **performance** of microfinance has been better than the performance of the rest of the financial system
2. ► the crisis revealed differences in the success of alternative credit **technologies** during the cycle
  - individual better than group credit technologies
3. ► **Bolivia is not experiencing a crisis of microfinance ...**

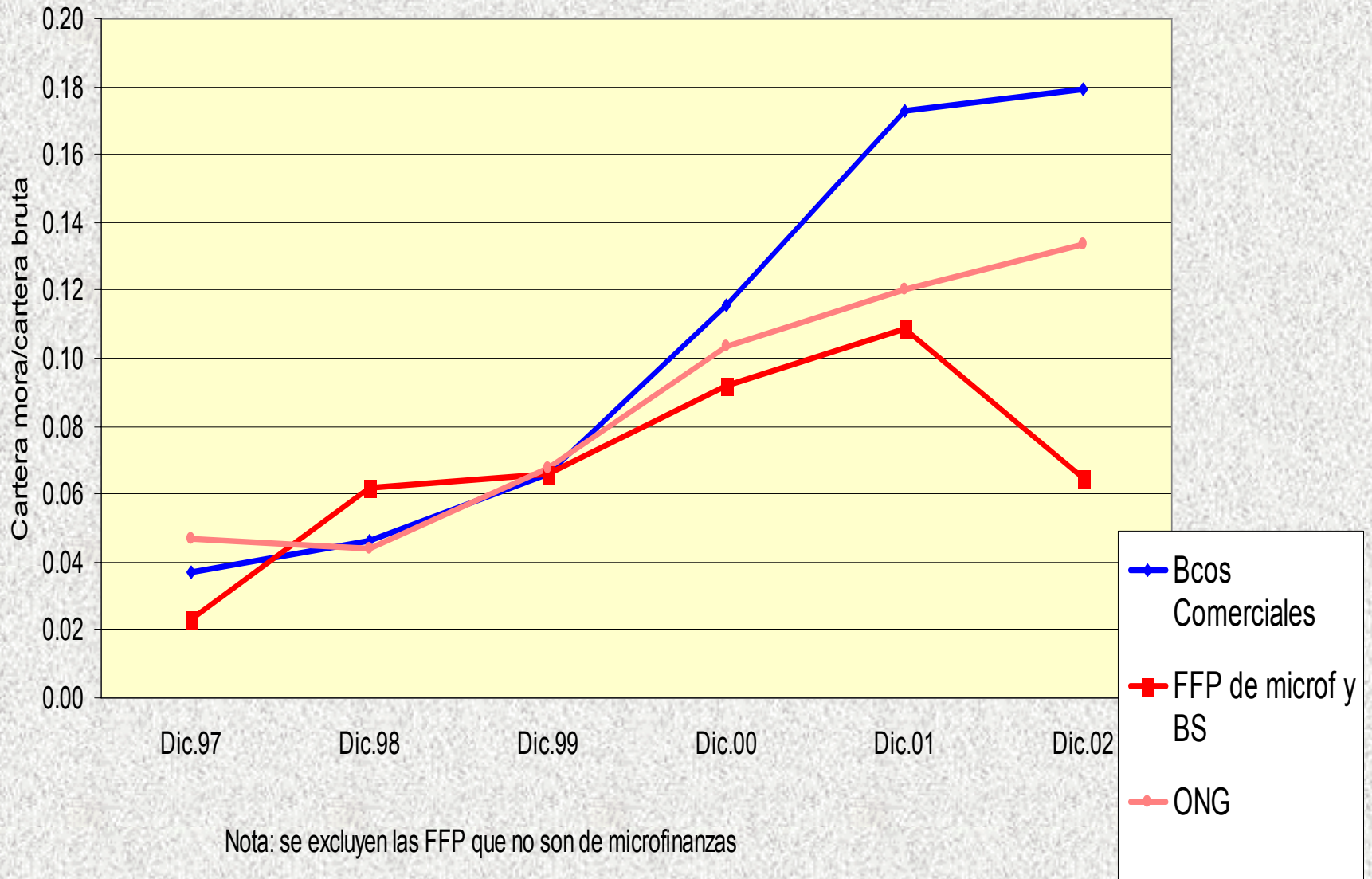
**Rather, it is testing the robustness of microfinance in times of crisis**

# Evolution of outstanding portfolios in the financial system



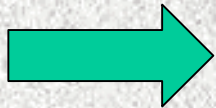
**Jorge Rodriguez**

## Default in the Bolivian financial system



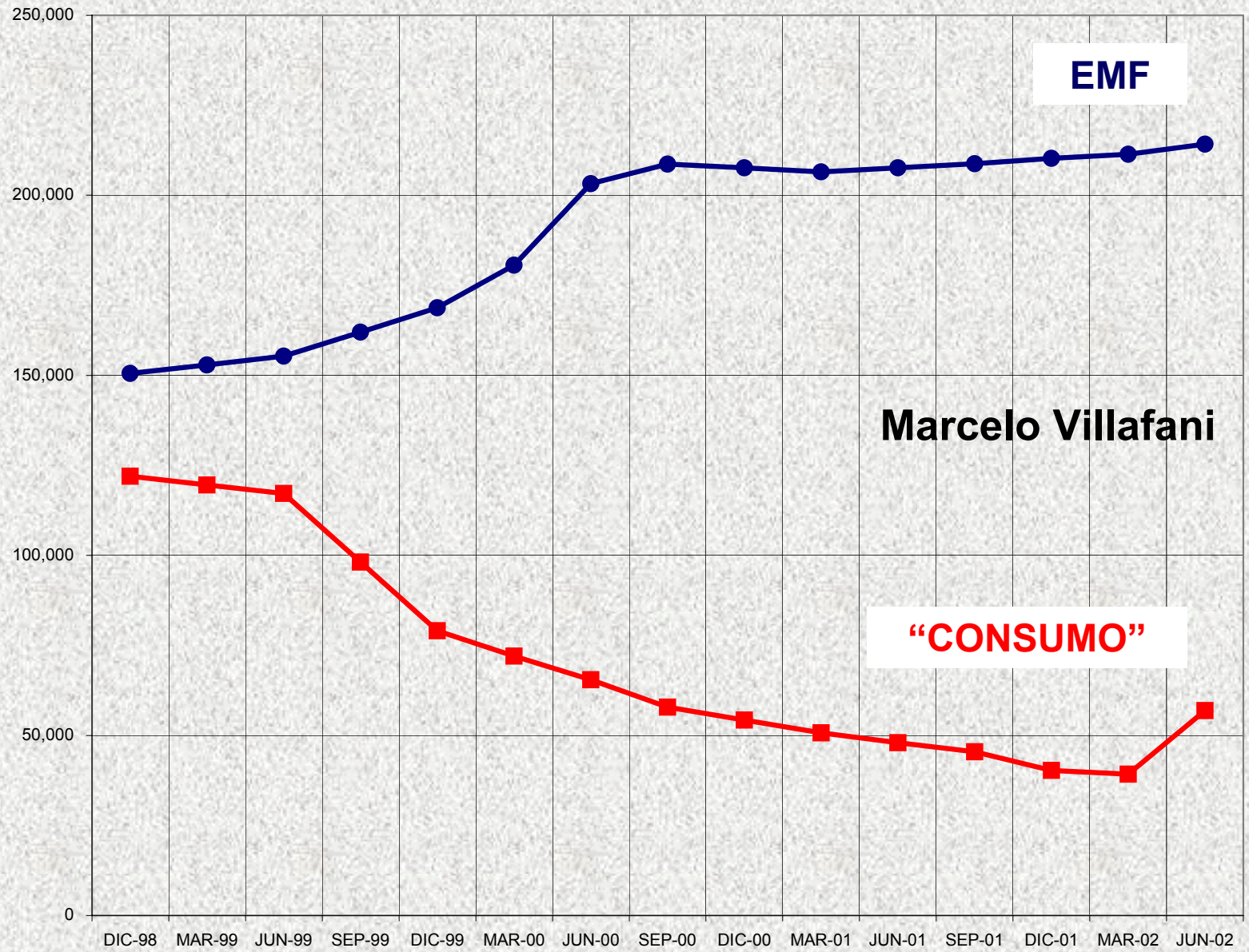
# Reasons for performance of microfinance

- ▶ **INNOVATION**
- ▶ **FLEXIBLE CLIENT STRATEGIES**
- ▶ **GREATER FINANCIAL DISCIPLINE**
  - **LESS OPPORTUNISTIC BEHAVIOR**
  - **LESS BAILING-OUT EXPECTATIONS**
  - **MORE COMPETITION**



**CHANGES IN MARKET  
STRUCTURE**

# Evolution of the number of borrowers

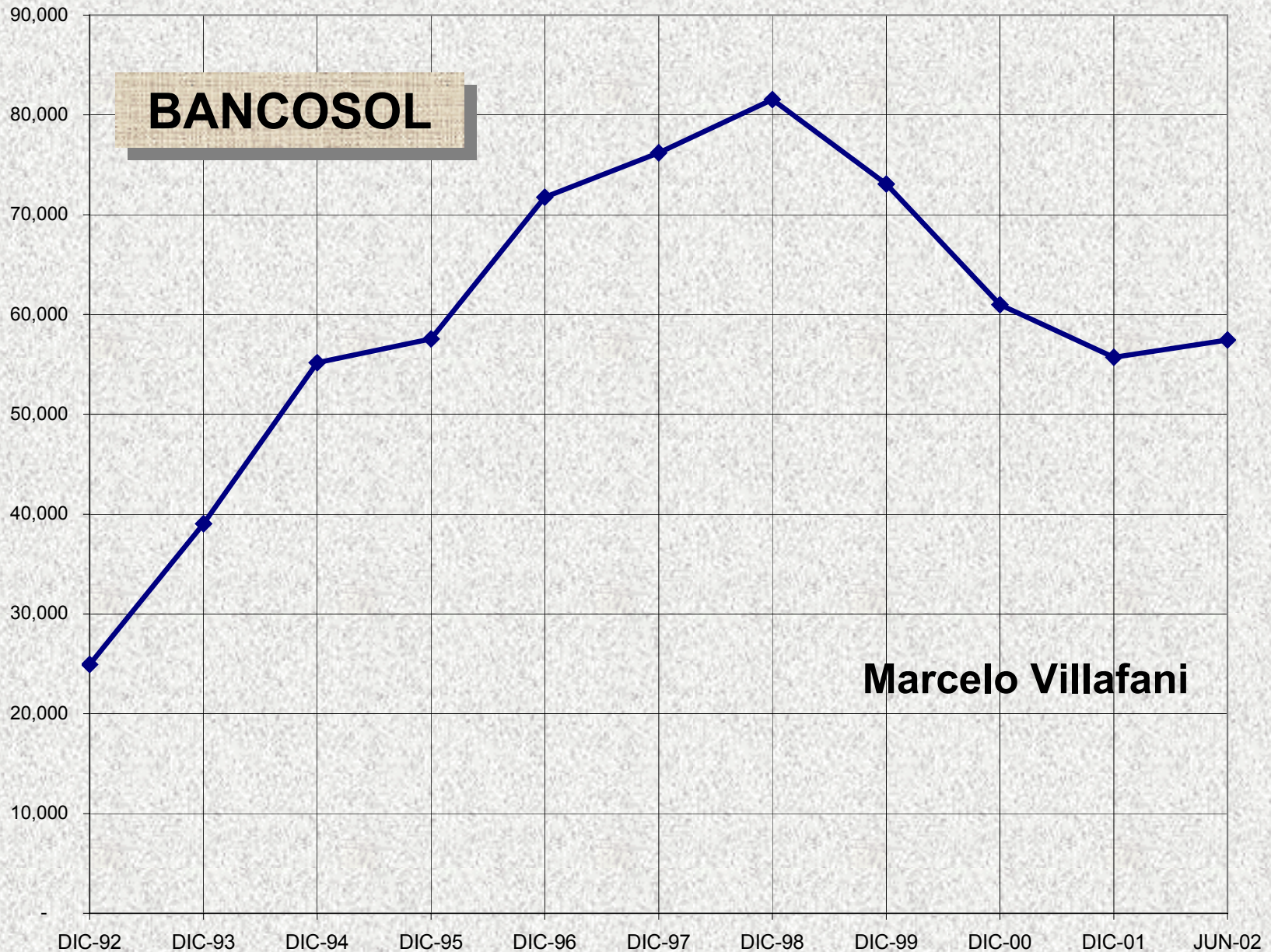


**EMF**

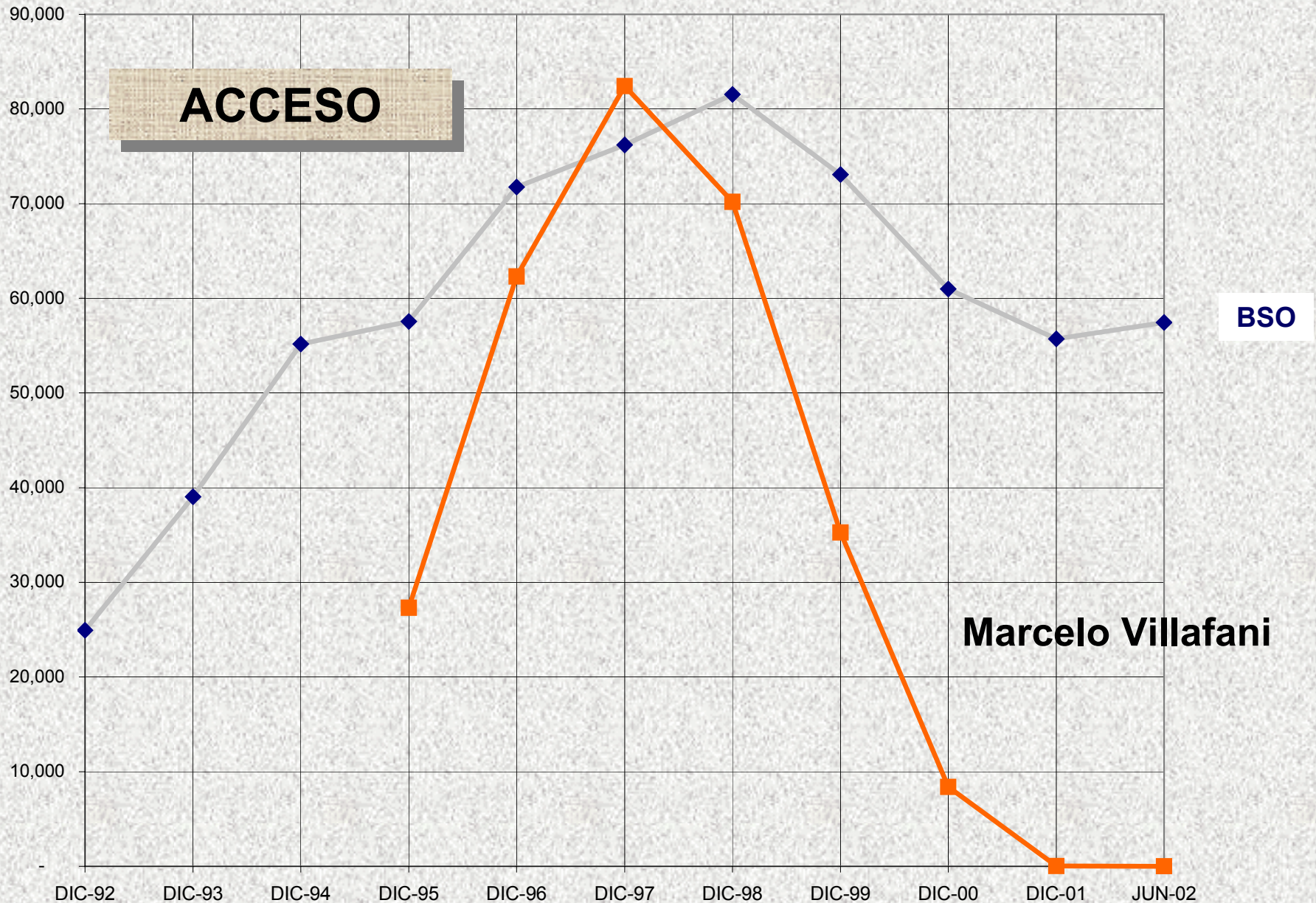
**Marcelo Villafani**

**“CONSUMO”**

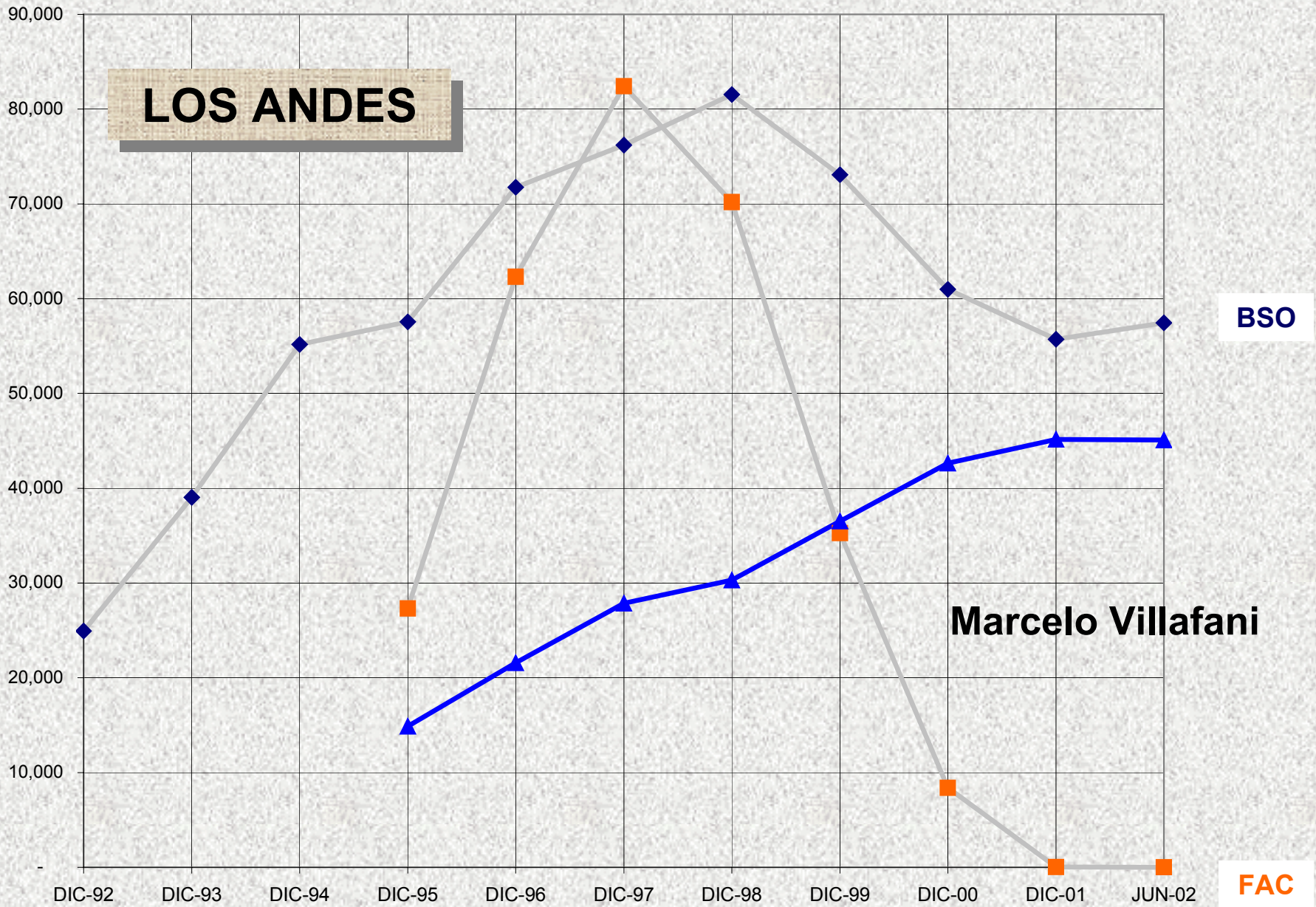
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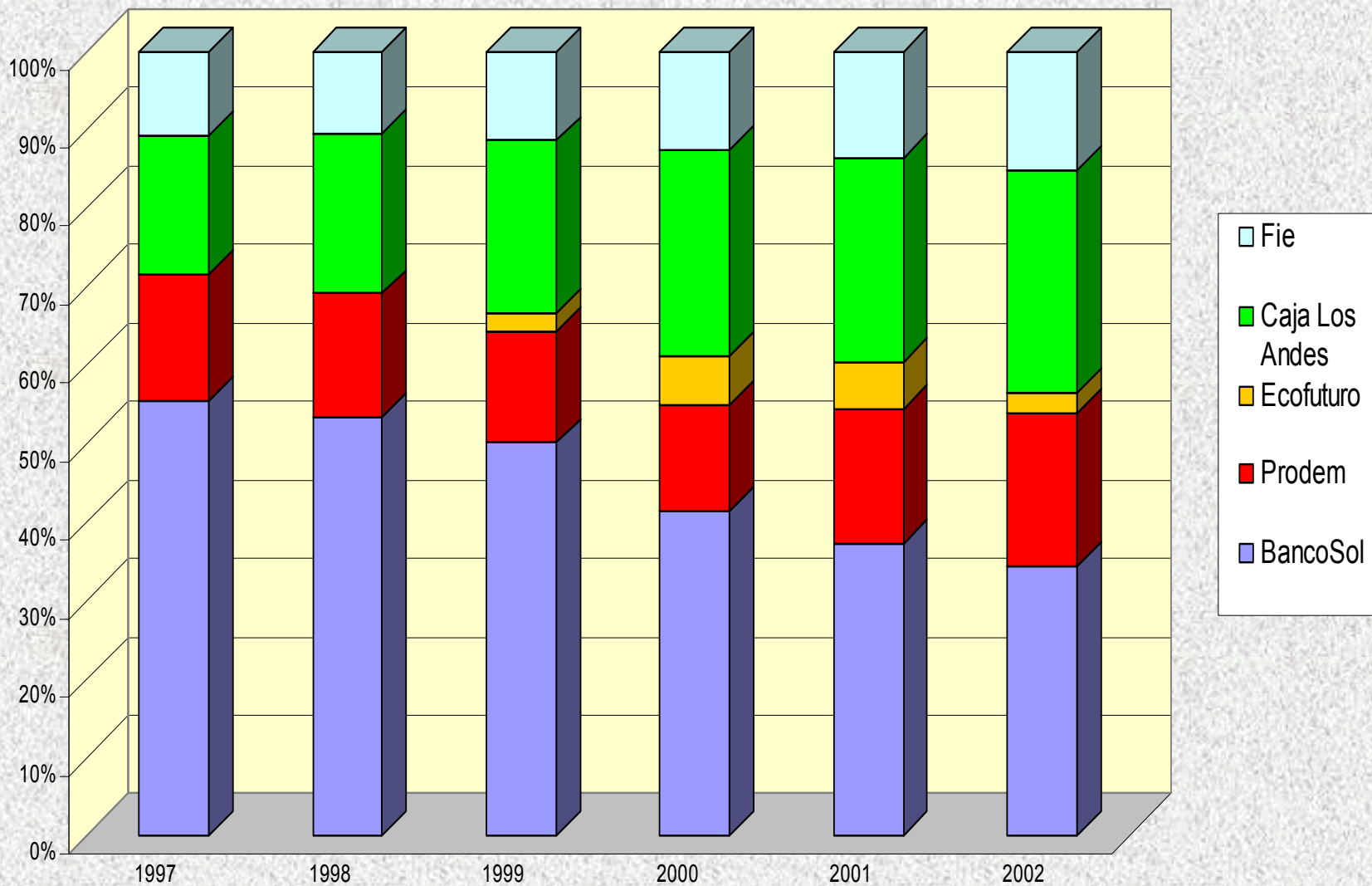
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# Number of borrowers

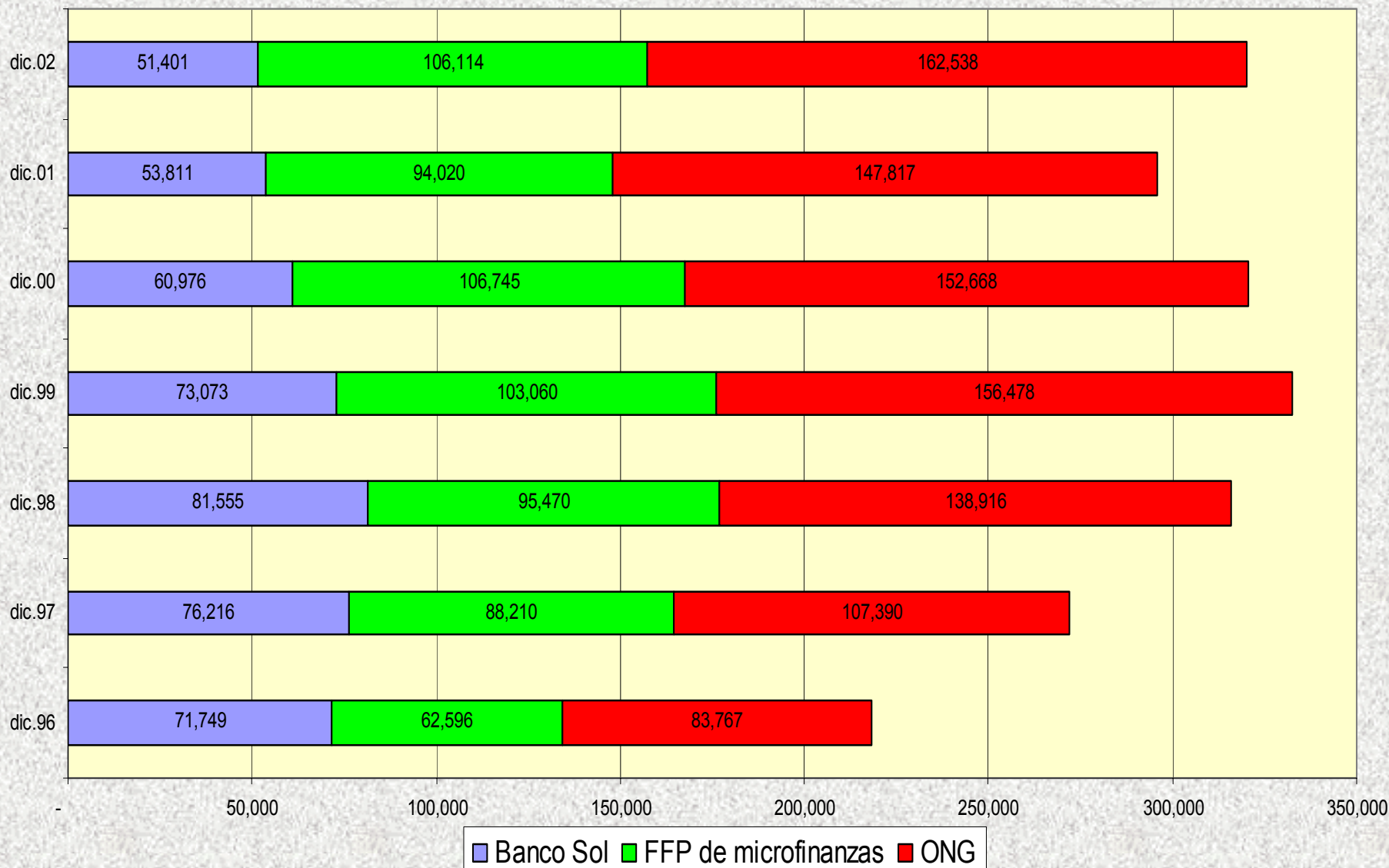


### Participación relativa en el mercado de microfinanzas excluyendo ONG



Fuente: SBEF y Finrural

## Número de clientes de microfinanzas excluyendo a las cooperativas



Fuente: Finrural y SBEF

**thanks**