Commercialization and Crisis in Bolivian Microfinance

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Commercialization and Crisis in Bolivian Microfinance

by

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COMMERCIALIZATION AND CRISIS IN BOLIVIAN MICROFINANCE[1]

In microfinance circles, Bolivia is often thought of as the model for commercial microfinance. Bolivia is known for its successful microfinance institutions (MFIs) that have transformed from their original status as NGOs into regulated commercial institutions, including BancoSol, the first and perhaps best-known transformed microlender. These MFIs constituted a thriving microfinance industry operating largely on commercial principles through the mid-1990s. Bolivia's experience of commercial microfinance took on a new dimension towards the end of the 1990s, caused by the growth of the transformed MFIs to a level at which the market for prime urban microfinance clients began to be saturated and by the entry (and subsequent retreat) of consumer lending. A third trend, commercial organizations taking up microenterprise lending, also affected Bolivia, but in a much smaller way. These events took place at the same time that Bolivia's economy, like other economies in South America, suffered a major shock and recession, felt especially hard by microentrepreneurs. These events led to a crisis in microfinance starting in late 1999 and still ongoing as of mid-2001, in which borrowers became overindebted and institutions suffered dangerously high delinquency and falling profits.

This paper discusses the state of the industry before the crisis, the changes that shook the industry, and the responses that microfinance institutions and regulators have made. It illustrates several important issues at the core of microfinance commercialization: the dynamics of overlending, pressure on traditional microfinance methodologies, the interconnections of consumer lending and microfinance; and the impact of commercialization on clients. Such changes have thrust microfinance decisively into a new era, both in Bolivia and around the world.

After a brief discussion of the current size of the sector and some aspects of the policy setting that made commercialization possible, we will look at three sets of commercial players in Bolivian microfinance: the traditional microlenders who had transformed into commercial institutions, a number of new purely commercial entrants, and the consumer lenders.

In 2000, the total number of microenterprise loans outstanding in Bolivia was approximately 400,000 (see Table 1. Includes cooperatives; rounded to emphasize that precision in this number is difficult because of differences in definitions across institutions.). Total coverage of microcredit included a large share of the estimated national market of 600,000 to 1,000,000 microenterprises, although there is no way to know how many separate clients this number represents, because borrowers often take loans from several institutions at once. The total active loan portfolio associated with these microenterprise loans) was $379 million at the end of 2000, representing just over 10 percent of the overall loan portfolio of the financial sector. In terms of numbers of clients, microcredit exceeds the rest of the financial sector. The majority of these loans are provided by formal financial institutions without significant

[1] This chapter is adapted from Chapter 6 of Elisabeth Rhyne, *Mainstreaming Microfinance: How Lending to the Poor Began, Grew and Came of Age in Bolivia* (Connecticut: Kumarian Press: 2001).

external subsidies (Cooperatives, BancoSol and FFPs), and the remainder (NGOs) have reduced their subsidy dependence drastically over the past five years.

Table 1: Microfinance Loans in Bolivia by Institution, December, 2000

Institution	Type of Lending	Borrowers	Portfolio (US$ million)	Avg. Loan Balance	Number of Branches
BANKS					
BancoSol	**SG, In**	**60,976**	**77.8**	**1,276**	**37**
FFPs					
Acceso (consumer only)	In	8,400	5.4	643	4
EcoFuturo	SG, In	14,604	11.2	767	8
FIE	In	23,402	22.5	961	15
Caja los Andes	In	42,643	46.8	1,097	17
Prodem	SG, In	26,096	23.6	904	52
FASSIL	SG, In, As	23,493	15.4	656	7
TOTAL FFPs		**138,638**	**124.8**	**901**	**103**
COOPERATIVES					
Coop. Jesús Nazareno	SG, In	17,809	49.0	2,751	14
Coop. San Martin de Porres	SG, In	5,173	23.5	4,543	11
Eight Other Cooperatives	SG, In	26,875	38.9	1,447	34
TOTAL COOPs.		**49,857**	**111.4**	**2,234**	**59**
NGOs					
Aned	SG, In,As	38,842	7.4	191	25
Crecer	As	24,684	3.5	142	13
Diacona-Frif	SG, In	11,213	6.0	535	16
Fades	SG, In,As	22,426	11.7	522	25
Idepro	SG, In	8,313	6.5	782	11
Pro Mujer	In,As	23,866	3.5	147	23
Five other NGOs	SG, In	23,324	25.9	1,110	39
TOTAL NGOs		**152,668**	**64.5**	**422**	**152**
TOTAL		**402,139**	**378.6**	**941**	**351**

As= associations; SG= solidarity groups; In= individual
Source: Boletín Financiero Microfinanzas, Asofin, Cipame, and Finrural, December 2000.

PRECONDITIONS: A MODERNIZING BOLIVIAN FINANCIAL SYSTEM

Bolivia's financial sector reforms, together with inflation control, set favorable conditions for the creation of advanced microfinance institutions. The same reforms also created the conditions for commercial entry into the low end of the banking market.

Until the 1990s, as in many developing countries, most Bolivian banks were controlled by a single individual, business group, or family. Predictably, they were inefficient, with high administrative costs and few innovations in banking services. However, starting in the late 1980s, financial sector reforms turned this oligopoly upside down.

The reforms aimed to restore confidence in the banking system, confidence shattered during Bolivia's 1984-85 hyperinflation which left the entire Bolivian banking sector with only $60 million in loans outstanding.[2] Successive governments gradually rebuilt trust through four major steps. In step one, they liquidated the state banks, which lost money, were corrupt, and lent to elites. The reformers viewed these banks as too hopeless even to privatize. In step two, they began to modernize the legal framework for the banking system. They strengthened the Superintendency of Banks, giving the superintendent significant independence from political control. New legislation also prohibited insider lending, endemic in traditional Bolivian banking. In step three, the government applied these new legal and administrative tools to weed out weak banks. Fifteen of the 35 banks were closed or restructured, in most cases because of severe undercapitalization. In step four, during the late 1990s, the government began allowing foreign banks to enter the market, alone or in partnership with local banks. Bolivia needed foreign banks to supply the equity capital local banks lacked and to increase efficiency. With access to plentiful and relatively inexpensive capital, banks with foreign partners could invest in modernization and innovation, guided by their partners' knowledge of the latest technologies.

The reforms brought depositors back into the financial system. From a few millions in 1985, the total amount of loans outstanding reached $4.9 billion at the end of 1999 before falling back to $4.2 billion in the recession of 2000.[3] Interest rates and spreads also fell throughout the reform period, suggesting improvements in efficiency and more competitive pricing.

Of direct relevance to microfinance, the entry of foreign banks increased competition. The foreign-owned banks began luring prime corporate customers, using their access to cheaper funds to offer lower interest rates than the local banks. In response to saturation in the corporate market, local banks started searching for competitive niches downmarket. Yet at this level, too, foreign banks are a formidable force. The foreigners bring techniques for retail banking, particularly consumer lending.

Critics of financial sector reform programs often charge that without directives banks will leave the poor with fewer services than before. Reform advocates answer that market forces will press financial institutions downmarket. Bolivia's experience proves both views partly right. Competitive pressure in Bolivia does indeed drive banks downmarket. However, Bolivia's experience also shows that before entering, banks need to see and understand how profits may be made in these markets. In Bolivia's case, although two models have been available for reaching down, the formal banks felt much more comfortable with consumer lending than with microenterprise credit.

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[2] Source: Mario Riquena, Ministry of Finance, interview with author. In this chapter references quotes or paraphrases of individuals are from interviews with the author carried out in March 1999 and March 2000.

[3] Superintendencia de Bancos y Entidades Financieras, *Boletin Informativo* Año 12 – N° 149 (December 2000): page 10.

THE PLAYERS IN BOLIVIA'S COMMERCIAL MICROFINANCE INDUSTRY

The Transformed Microfinance Institutions

It is characteristic of the Bolivian industry that private, formal financial institutions provide the majority of services. The dominance of formal financial institutions is a relatively recent development, however, as microfinance in Bolivia originated with donor support to NGOs which only later transformed into formal financial institutions. These transformed institutions demonstrated to Bolivia—and to the international microfinance movement—that microfinance could operate commercially.

BancoSol

A look at transformed institutions must begin with the first such institution, Banco Solidario, S.A. (BancoSol), a licensed commercial bank.[4] For most of its life this extraordinary institution offered one basic loan product, the solidarity group loan for microenterprises. On the strength of that sole product, it generated performance indicators that placed it at the top of the Bolivian banking industry during the mid-1990s. Every March, the Superintendency of Banks publishes data on the banking system's performance during the previous year, numbers the press reports with fanfare. In 1999, as in each of the previous three years, the newspaper headlines stated, "BancoSol was the best local financial entity."[5]

In the mid-1990s BancoSol consistently topped the list on three of the five key performance indicators measuring bank performance: return on assets (5.2 percent in 1998), asset quality (0 percent) , and capital adequacy (16.3 percent).[6] These are unusual and outstanding figures for a bank in any country. Most banks would be happy with return on assets at or above 1 percent and arrears of less than 2 or 3 percent. The minimum standard for capital adequacy in Bolivia is 12 percent, and most banks struggle to maintain it. Although BancoSol was never the leader in return to shareholders' equity, not being as highly leveraged as other banks, its 29 percent return on equity in 1998 placed it among the top-performing banks. Only in administrative efficiency did BancoSol score below the norm reflecting the high cost of microfinance relative to volume. When a microfinance bank put everything together to produce a bank both safe and profitable, people began to notice, and BancoSol's example has been imitated, both in Bolivia and internationally.

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[4] The process of BancoSol's transformation is detailed in Deborah Drake and Maria Otero, *Alchemists for the Poor: NGOs as Financial Institutions.* Monograph Series No. 6 (Cambridge, Mass.: ACCION International, 1992) and Amy Glosser, "The Creation of BancoSol in Bolivia,"in *The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*, ed. Maria Otero and Elisabeth Rhyne (West Hartford, Conn.: Kumarian Press, 1994); and Frankiewicz, *Building Institutional Capacity: The Story of PRODEM, 1987-1999* (Toronto, Calmeadow: 2001).

[5] *La Razon, Economía y Negocios*. La Paz. February 21, 1999, 1.

[6] *La Razon, Economía y Negocios,* 5. The delinquency indicator used in the newspaper is more lenient than the indicator used elsewhere in this chapter.

BancoSol has been hard hit by the recent crisis in microfinance, as we will discuss below. Nevertheless, it retains a leading market position. At the end of 2000, it was serving 60,976 clients through 37 branches, located mainly in urban areas. Its loan portfolio was $78 million.[7] Slightly over half the loans were to solidarity group clients, with the remainder to individuals. The average size of loans was $1,276 (outstanding balances). BancoSol also provides savings services, through savings accounts and time deposits.

Fondos Financieros Privados

The next tier of microfinance providers are the private financial funds (FFPs), as well as several NGOs in advanced stages of converting into FFPs. FFPs are formal financial institutions able to engage in a wide range of lending and some savings activities. Their minimum capital requirements are lower than those for commercial banks and they are not allowed to provide certain services banks provide. The government created this category in 1994, especially to accommodate the emerging microfinance industry. Much of the work to create the regulations for FFPs revolved around a specific case, Procredito, an NGO which spawned the first FFP, Caja los Andes. Several other microfinance NGOs have since become FFPs: PRODEM, FIE, and EcoFuturo (formed by a group of NGOs: FADES, IDEPRO, ANED, and CIDRE). Taken together, the four transformed FFPs held roughly 107,000 loans outstanding at year-end 2000.[8] The process of transformation has been one of the major contributions of Bolivian microfinance to international experience.[9]

Although these institutions share the same regulatory category, each has a unique personality. Caja los Andes is a no-nonsense, focused financial institution, which had a total of 42,643 clients at year-end 2000, with an active loan portfolio of $47 million.[10] Its strong individual loan methodology makes it a formidable competitor in the urban areas where it operates. FIE, the other La Paz-based individual lender, has a somewhat softer image and aims to support the broader development of the enterprises it serves.

Another large organization in this group is Prodem, the original NGO from which BancoSol was born, which became an FFP in 2000. After it spawned BancoSol, Prodem turned its attention to the still unserved rural population. It has since developed the best nationwide outreach in rural areas, which gives it a strong market position as other institutions begin pushing out from the major cities. With 52 branches, it has more outlets than BancoSol, and 26,000 clients.[11]

None of the FFPs is primarily savings-based, although most are licensed to offer savings accounts and time deposits. In general, this bias reflects their histories as NGOs not

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7 ASOFIN, CIPAME, and FINRURAL, "Microfinanzas: Boletín Financiero,"La Paz: December 2000.
8 ASOFIN, CIPAME, and FINRURAL, "Microfinanzas"December 2000.
9 For a detailed account of the Bolivian model of microfinance transformation, see Rhyne, *Mainstreaming Microfinance*, Chapter 5.
10 ASOFIN, CIPAME, and FINRURAL, "Microfinanzas"December 2000.
11 ASOFIN, CIPAME, and FINRURAL, "Microfinanzas"December 2000.

authorized to take savings and as consumer lenders. Moreover, it reflects prevailing attitudes that poor Bolivians don't save and/or that capturing deposits from them is too costly.

Bolivia's microfinance sector also includes a number of strong NGOs that do not intend to become regulated institutions. These NGOs tend to have a more poverty-oriented and rural focus than their commercial counterparts. At the height of the growth phase of FFPs, it looked like NGOs were becoming less relevant in Bolivian microfinance, particularly if scale is viewed from the point of view of portfolio size, where they make up only 17 percent of the total microloan portfolio. However, several NGOs are growing rapidly, and together they account for 153,000 or 38 percent of total microfinance loans in Bolivia, counted by number of loans rather than dollar volume. Although they will likely remain NGOs, these organizations are deeply affected by the commercialization going on around them, in areas ranging from financial performance standards (demands that they perform nearly as well as the formal institutions) to competition for clients. This chapter does not examine all the NGOs, but focuses on one urban village banking NGO, Pro Mujer, to give some flavor of the experience of NGOs during commercialization and the crisis.

Commercial Entry into Microfinance

In the private sector, several institutions observed the microfinance lenders and decided they could compete profitably in the same marketplace. Though relatively small in numbers of clients, this kind of entry is potentially important because it was not launched through donor subsidy. We will look briefly at three types of entry: a specialized lender, Fassil FFP; a bank with an interest in going downmarket, Banco Económico; and the general category of credit cooperatives.

Alfredo Otero, the founder and former chief executive of Fassil, began thinking about starting his own financial institution during early 1990s, when he observed that bank failures were not caused by small loans, and that, in fact, banks with small loans were the least likely banks to fail. He also saw that Bolivian banks provided poor quality services to their retail customers and thought he could do better. He assembled a group of eight investors, all local private businessmen, who together met the minimum $1 million initial capital requirement to become an FFP, and opened Fassil in 1996.

Fassil's strategy was to start with consumer lending in order to build volume and obtain profits quickly while its microcredit portfolio grew to a profitable level. Gradually, it planned to increase the share of business devoted to microcredit, where it saw its long term future. In fact, the crisis of consumer lending, described below, led Fassil to shift its focus to microcredit sooner than anticipated. Of Fassil's 23,500 clients at year end 2000, the institution classified three quarters as microenterprise clients.[12]

To learn consumer credit, Fassil's founders went to Chile to study consumer lenders and then contracted a team of Chilean design consultants. To learn microcredit, they recruited experienced microenterprise lenders, largely from BancoSol. Otero's team began by applying

[12] FASSIL internal reports through June 2000.

the BancoSol solidarity group methodology at Fassil with few alterations. Fassil offers a variety of microloan products, including a small, but successful pawn loan service, offering cash on the spot to people pledging gold jewelry.

When Fassil entered microenterprise credit, competition was increasing quickly through the growth of established microlenders. Yet Fassil lacked the start-up subsidies and access to preferred sources of loan capital that the donor-backed microfinance institutions had. Nor do its investors have the deep pockets of an international banking partner. It will be interesting to see how well this example of local entrepreneurship survives competitive pressures.

Another entrant into the microcredit scene was Banco Económico, a commercial bank launched by eighteen private businesspeople in 1991 to focus on the small and medium enterprise sector in Santa Cruz. During the mid-1990s, Banco Económico showed returns on equity higher than any other Bolivian bank. Rates of return on equity between 1993 and 1997 ranged between 18 and 35 percent. Measured on this critical indicator of profitability, Banco Económico outperformed BancoSol during the period, which scored better during those years on return on assets, but not on equity.

Banco Económico began including microenterprises as a part of its overall target market early in its existence, making few distinctions between microenterprises and other businesses. It began locating branches near large informal markets, recognizing that many informal operators move large sums of money. It infused standard commercial banking methods with a strong orientation toward efficiency and service quality. Banco Económico was the first bank to break ranks on bankers hours, by opening during lunchtime. In 1997, Banco Económico opened its Presto division to focus specifically on micro and consumer credit. By mid-1999, however, the crisis which struck Bolivian microfinance and the consumer credit sector led Banco Económico's board and management to close the Presto division and remove itself completely from the microcredit market.

A third source of commercial entry into the microfinance market is represented by several Santa Cruz-based savings and credit cooperatives who have launched specific microenterprise credit products. Although the cooperatives were started with altruistic motivations and connections to donor agencies, it is now appropriate to consider them commercial entrants because they operate commercially, their funding derives from private sources (member savings), and they have started microcredit recently purely as a market venture.

The cooperatives claim that they have served microenterprises throughout their history. Nevertheless, until recently, they have not used the methodologies of the self-identified microfinance institutions or competed directly for microenterprise clients. Their lending formula has been based on membership in the cooperative, with loan size determined as a multiple of the client's savings deposits. By early 1999 at least five of the cooperatives in Santa Cruz had begun to offer solidarity group loans as a regular part of their business, using techniques taken directly from the leading MFIs, often by hiring staff from BancoSol and others.

Fassil, Banco Económico, and the large cooperatives illustrate the limited way the private sector began dipping its toe into microcredit. Only Fassil staked its future on microcredit, with its microfinance portfolio representing the dominant portion of its total portfolio. The others experimented with microcredit at the margins of a wider array of markets and services.

THE RISE OF CONSUMER CREDIT

Consumer credit has had momentous impact on microfinance in Bolivia. This lending methodology was imported into Bolivia from the developed world of salaried workers and consumer durables. It arrived in Bolivia via Chile, where it had burgeoned during the past decade. Consumer lenders offer loans of about the same size as microenterprise loans, very quickly and flexibly, primarily on the basis of a worker's salary. While in theory the market for consumer lending is distinct from the microcredit market—salaried employees versus informal enterprises—in practice there has been a great deal of overlap.

A brief portrait of Acceso FFP, the first large consumer lender in Bolivia, will serve to tell the story of consumer credit. Acceso represented the entry of foreign capital and know-how. The owner, a large Chilean holding company, Empresas Conosur, operates home improvement centers, automobile dealerships, and a variety of other businesses that appeal to the growing Latin American middle class. A multinational company with ten years experience in consumer lending, Conosur is expanding its subsidiaries into Peru, Paraguay and Bolivia.

The Acceso methodology is a product of the information age, made possible by the availability of credible information about prospective clients and by technology for managing masses of information efficiently. The fundamental basis for lending is the ability to tap a borrower's steady salary as the source of loan repayment.

When Acceso first entered Bolivia, it sought customers among the employees of prime companies. Large, stable employers provided trustworthy information about a loan applicants' employment and salary and were willing to arrange loan repayment through payroll deduction. For customers with less-than-prime employers, Acceso relied on its own sophisticated credit scoring model. Credit scoring rates each applicant based on his responses to objective questions linked through a model based on extensive past data to the probability that a client will repay. Questions range from simple personal information, to employment history, type and location of residence, and credit experience. Credit scoring models distill vast experience into a powerful though mechanical predictive process, where formerly that experience would have found expression in a set of policies applied through the judgment of a veteran credit officer.[13]

The internal management of loans also differs drastically from microcredit, which is based on loan officer responsibility for the whole client relationship (See Table 2). Alfredo Otero, founder of Fassil, which introduced a similar methodology, describes consumer lending as a

[13] For more on credit scoring techniques employed in consumer lending, see Edward M. Lewis, *An Introduction to Credit Scoring*, Fair, Isaac and Co., Inc.: San Rafael, California. 1993.

credit factory. Acceso, for example, broke loan approval and collection into at least eight separate steps, each performed by a different person. In assembly line fashion, each person performs her task very efficiently, and various people cross-check the work of others for quality control. The process begins with credit officers, really salespeople who earn most of their money on commissions. These people bring customers through the point of completing a loan application. Separate staff enter data, verify data accuracy, evaluate the credit (using credit scoring), verify client identity, notarize documents, disburse, and collect. These steps are done so efficiently that Acceso claimed to disburse first loans within forty-eight hours, and second loans within twenty-four. In contrast to microcredit, credit officers have no role in the important steps of verification, evaluation, or collection.

Table 2: Comparison of Bolivian Microcredit and Consumer Lending

Parameter	Microenterprise Credit	Consumer Lending
Loan terms	Average near $1000; short term; fast turnaround; competitive interest rate	Average near $1000; short term; fast turnaround; competitive interest rate
Basis for loan approval	Enterprise and household cash flow; credit history, group guarantees	Salary; credit “score”
Basis for repayment	Motivation for continued access to credit; peer pressure	Steady salary and ability to garnish wages
Tolerance for delinquency	“Zero Tolerance”policy. Expected delinquency: Less than 3-5%	Not worried until after 30 days late. Expected delinquency: 15-20 %
Method of follow-up	Immediate, personal visit	A letter in the mail
Staff organization	Loan officer responsibility for client from start to finish	Assembly-line loan processing.
Basic philosophy	Trust and responsibility	Information management

Using such a methodology and a workforce of over 1,000 people, Acceso reached a total of 90,000 loans outstanding during its first three years, a scale that BancoSol had not achieved in the twelve years following its origin as Prodem. This build up was part of a purposeful strategy to reach scale quickly in order to gain market share and begin earning profits after a short time. Acceso was not alone, however. Nearly all the Bolivian banks also started consumer credit operations using virtually identical techniques. Estimates were that in mid-1998, the Bank of Santa Cruz’s Solucion program had another 40,000 clients, as did Union Bank’s CrediAgil program.[14] One banker estimated that at its peak the system had about $150 million in consumer loans outstanding, approaching the aggregate size of commercial microcredit.

If consumer lending kept strictly to prime salaried employees, the microlenders would have overlapped with them to some degree because many families include both salaried and independent people; sometimes the same individual has both a salary and a business. The overlap was exacerbated by the fact that Bolivia has so few prime employers. To achieve desired volumes, consumer lenders moved to lower grade employers and to independents

[14] Müller and Associates, “Evaluación del Sistema Financiero Nacional,”*Informe Confidencial* no. 115 (Mar-Apr 1998), 13.

(their name for microenterprises). Acceso's managing director, André La Faye, estimated that about 30 percent of Acceso's clients were independents. At Acceso's peak, this percentage would represent more than 25,000 clients, similar in scale to several microfinance FFPs in number of microenterprise loans. Thus, consumer lenders competed directly with microlenders.

Direct competition is always a challenge, but because the competition represented a very different lending philosophy, the challenge threatened microlenders on two related dimensions: tolerance of delinquency and overlending.

The consumer lenders were far more lax on delinquency than the microlenders. The consumer lenders assumed that a large share of clients would pay late, and they built these expectations into their pricing. According to staff, Fassil's original planning models assumed delinquency levels around 17 percent, with write-offs of about 7 percent. Coming from more developed countries, consumer lenders use automated collection measures for handling most late payments, printing and mailing form letters to delinquent clients, a dramatic contrast to the immediate loan officer visits microlenders make to delinquent clients Consumer lenders only initiate visits for the small share of delinquencies that continue for weeks. La Faye, for example, did not consider a loan worth following up at all until its delinquency exceeded 30 days. Consumer lenders charge fines for late payment that actually increase their revenues when clients are a little late, making a few days or a week of delinquency welcome, not just tolerated.

Bolivian microlenders saw such practices with alarm. Without the salary to fall back on, microlenders have always felt exposed to changes in attitudes towards repayment that can sweep like contagion through an institution's clientele, and held fast to immediate (one day), personal follow up of missed payments.

The consumer lenders increased risk through aggressive marketing. They began moving into the microenterprise sector in a big way, but without changing their methodology. Instead of adopting techniques designed for informals, they piggybacked on the screening done by the microlenders. The technique was simple: lure the good clients away from microlenders by offering them larger loans (and faster, and at lower rates, but mostly larger). The consumer lenders thought they would be safe if they targeted clients in good standing among the microlenders. Microlender staff were intensely frustrated that new entrants systematically targeted their best clients as a low-risk strategy to invade the microcredit market. They also noted that the big banks could offer cheaper interest rates by spreading their fixed costs among their large corporate clients. These banks might even operate microcredit or consumer operations at a loss for a time because these portfolios are only a small percentage of their overall assets. Microfinance staff worried that big banks could therefore engage in dumping practices to drive others out of the market.

As it turned out, the consumer lenders should have given more heed to the market knowledge of the microlenders. After what in hindsight turned out to be reckless entry, default shot up among consumer lenders and microlenders alike during 1999 and 2000, creating the crisis of *sobreendeudamiento* (overindebtedness).

THE CRISIS OF 1999-2000

Causes of the Crisis

The aggressive tactics of the consumer lenders exposed Bolivian microfinance institutions to an extreme level and particular type of competition. However, even without their entry, the growth of the microlenders themselves and the entry of more conservative commercial players like Fassil and Banco Económico would have led towards saturation and increasing competition. By 1997 the estimated total number of active microfinance loans had reached nearly 300,000, with the number of consumer loans also approaching that level. The total microfinance loan portfolio was about $170 million. Taking the rough market estimate made by second-tier lender Funda-Pro, that is, a total of 600,000 microentrepreneurs in Bolivia, market penetration by microfinance alone was near 50 percent. This percentage, together with another substantial portion of the market receiving consumer loans, gives a very high market penetration index, especially considering that not all clients want or qualify for a loan at any given time.

Clients took advantage of the offer of quick and easy credit from so many institutions to borrow from multiple lenders, maintaining two or more loans outstanding at a time. In an increasing number of cases, clients borrowed more than they could handle. Some let repayments slip, or in worst cases, they began bicycling loans—using the proceeds of one loan to pay off another. Such behavior seriously damaged the carefully constructed culture of repayment in microcredit.

When delinquency first began to rise at BancoSol, the bank found a close correlation between late clients and clients with loans at other institutions. According to Juan Domingo Fabbri of BancoSol's marketing department, clients do not see multiple loans as risky. His focus group research revealed, "The logic of clients is that they will earn more by investing more. Multiple loans have even become a status symbol."Moreover, clients who can maintain a relationship with two or more institutions may actually feel that they have reduced their risk by widening their choices, when in reality, for most borrowers, too much credit is a quick route to financial disaster.

The recognition that overindebtedness was becoming a problem dawned slowly on the microfinance lenders, because they had not prohibited multiple loans when there was less competition. Fassil staff, in fact, report that before the crisis, they had always seen themselves as a second lender to proven good clients. Several microfinance institutions now declare clients with a loan at another institution to be ineligible. Nevertheless, Carmen Velasco, Pro Mujer's executive director describes driving through a poor section of Cochabamba where delinquency had surged and finding delinquent Pro Mujer borrowers in the offices of several other microlenders. A recent study showed that a major share of Pro Mujer clients also had loans at BancoSol. In mid-2000, analysis showed that among the FFPs specialized in microcredit, 28 percent of the total number of loans and 34 percent of the value of the portfolio was held by clients with loans in more than one institution. The equivalent numbers were even higher for consumer lenders.

It was particularly unfortunate that Bolivia suffered its first serious economic setback after fifteen years of progress in 1999, just as the overlending phenomenon was heating up. The general economic crisis sprang from troubles throughout South America, starting with financial crisis and currency devaluation in Brazil. The ensuing recession hit the informal sector, the clients of microfinance, particularly hard, reducing demand for their wares both inside Bolivia and in export markets. Another contributing factor that hit the microenterprise sector was the crackdown on "informal"importing and exporting that took place as part of a reform of Bolivia's customs administration.

The fact that overindebtedness due to fierce competition coincided with Bolivia's economic slide propelled a significant problem to crisis proportions. After years of relative quiet, Bolivia began to experience heightened social unrest, with mass protests about things like water and electricity prices. Microfinance, too, felt the anger of the powerless. Interactions with clients started to sour, as loan officers spent more and more time wheedling collections from customers faced with too much debt and shrunken demand. These conditions set off a backlash against microcredit.

The Debtors' Revolt

A handful of "professional"union organizers began gathering borrowers into debtors associations to protest against the consumer and microfinance lenders. These associations grew quickly because organizers promised new recruits debt forgiveness. The leaders claimed to speak for several thousand borrowers. The associations staged protests, mainly at the offices of Acceso, CrediAgil, and other consumer lenders, but even at Caja los Andes and BancoSol. A few association members engaged in hunger strikes, a tactic with a long history in Bolivia. Through such tactics, the associations attempted to take the moral high ground by painting the lenders as exploiters of the poor. In petitions to authorities, they accused the lenders of using humiliating tactics against debtors – hiring mariachi bands to perform outside a debtor's house all night, painting the word debtor on the house, or broadcasting the names of debtors over the radio. They blamed the lenders for provoking every kind of social ill, from suicide to prostitution. They demanded full debt forgiveness.

The affected institutions, working through their newly created association, Asofin, sought aid from the courts to stop the demonstrations. Even though Asofin hired high-priced lawyers, the tearful testimony of a few market vendors carried the day. In fact, Asofin had scant legal basis for stopping the associations from mounting street protests. Eventually, the debtor associations forced their way into a dialogue with the Superintendency of Banks and Asofin, in which the microfinance lenders agreed to consider debt relief to association members on a case by case basis. Only a handful of cases were ever resolved, however. Shortly thereafter, the microlenders rejoiced when the associations threw their own leaders in jail. Apparently, one association was a true pyramid scheme where leaders illegally collected debt service payments due to the microlenders and used them to make new loans. Leaders of the other more legitimate association mishandled membership dues, a less spectacular crime, but enough to bring them down.

After a few months hiatus, however, the associations surfaced again with new leaders. This time they moderated their aims slightly: while acknowledging their obligations to repay debts, they asked for extended grace periods, longer loan terms, and annual interest rates of 2 percent. Tactics have escalated, however. In the most extreme example, demonstrators carrying dynamite took over the offices of the Superintendency of Banks, holding employees hostages and threatening to blow up the building. Although the debtors associations have been able to force their way into negotiations with government and financial institutions through such tactics, the concessions granted them have so far been minor. The major importance of the debt protestors has been to politicize microfinance, changing attitudes about credit and damaging Bolivia's once-excellent repayment culture. The microfinance industry will have to live with the debtors associations, or at least the attitudes they represent, for the foreseeable future.

The Fall of Consumer Credit

The members of the microfinance community were not the only ones concerned about the consequences of growing delinquency among the consumer lenders. The Superintendent issued regulations in early 1999 to place consumer credit on a sounder footing.[15] The most important provision limited the client's total debt service to 25 percent of her salary. Thus, if a client already had a substantial car, home, or business loan she would likely not qualify for a consumer loan. The response to this move varied. Fassil sharply curtailed consumer lending, switching almost completely into microcredit. Banco Económico quickly decided to exit from consumer lending almost before it had time to fully develop its Presto division. Acceso, it was widely rumored, went on much as before, simply paying the penalty the regulation carried.

The regulations came too late, however. By mid-1999 the consumer lending movement crashed. When the level of bad debt grew large enough to erode the equity of the two largest consumer lenders, Acceso FFP and the CrediAgil division of Union Bank, the Superintendent intervened directly in those institutions. At the end of 1998, Acceso had 88,000 clients, a portfolio of $93 million, and delinquency of 19 percent (already excessive). By the end of 2000, Acceso had only 8,400 active clients, and a portfolio of $5.4 million.[16] Much of the difference was written off. Acceso's investors lost their money and will not make any new loans.

In retrospect, it is easy to see that the consumer lenders came into Bolivia without understanding it. The models that worked in middle class Chile were not suited to less formal Bolivia. The lenders were also seduced by the success of the microlenders to think that their superior technologies could out-compete the charity-inspired institutions. They failed to recognize that their "credit factory" techniques lacked essential elements that made lending to microentrepreneurs work. Finally, they were unlucky to have run up huge portfolios just before an economic crisis.

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[15] Government of Bolivia, Superintendency of Banks, Circular 282 (La Paz, January 4, 1999).
[16] ASOFIN, CIPAME, and FINRURAL, "Microfinanzas"December 2000.

Responses to Increased Delinquency

The intensive overlending and subsequent collapse of consumer lending directly affected the microenterprise lenders. Although they suffered to a much smaller degree than the consumer lenders, they, too, participated in the rush to lend more money to the same clients and they, too, saw delinquency rise to unprecedented levels.

Each of the microfinance lenders has had to respond to increased delinquency through a combination of internal strategies and cooperation with government and other institutions. A first line of defense was greater use of the Superintendency's *Central de Riesgo*, or credit bureau. By the late 1990s, Bolivia already had a reasonably good system, designed for the formal banks. Because Bolivia had a national system of identification cards, even informal entrepreneurs could not easily avoid a bad credit rating by using assumed names. Through the credit bureau, staff at banks, FFPs, and now microfinance NGOs can log onto their computers, connect via modem, and immediately obtain a report on the outstanding indebtedness of any prospective applicant. Importantly, the system records outstanding loans, not just instances of delinquency, information necessary for determining whether a client is becoming overindebted. Unfortunately, the system was never sufficiently complete or up to date to provide a water-tight reference, and it was not good enough to prevent lending to many clients with multiple loans.

Microlenders also attempted to combat delinquency through the greater use of conventional ways of securing loans, spurred by tougher regulations from the superintendent. A first change has been greater emphasis on repayment capacity relative to past group performance. This line of policy could lead to regulatory norms on debt capacity analysis, similar to the Superintendency's limit on debt service as a percent of salary for consumer loans.

A second change was greater emphasis on tangible collateral. A new law will establish a registry of moveable goods that would allow clients to mortgage their equipment, an instrument that would improve on the current general purpose *prendaria* lien. The authorities want to see formal documents such as sales receipts for informal enterprises, which, almost by definition, have none. As collateral and documentation requirements creep higher, the difference between microfinance and conventional banking diminishes.

Delinquency affected internal operations as well. Caja los Andes and FIE had long motivated staff productivity using monetary performance incentives based on a loan officer's portfolio size and quality. They discovered that their incentive systems generated perverse results when delinquency worsened. Staff worked harder, spending inordinate amounts of time on collections, but still failed to meet the targets needed to earn incentives. The system quickly became counterproductive, generating bitter complaints. The organizations had to reformulate staff performance targets, allowing officers with previously unacceptable levels of delinquent loans to qualify, and focusing incentives narrowly on collections.

As a last resort, microlenders began to use rescheduling, in which a delinquent client is given more time to pay and smaller monthly payments. Until 1999, the microfinance lenders rarely rescheduled or refinanced loans, considering such practices highly risky. But in the midst of the economic crisis, they saw few alternatives. The Superintendency granted an amnesty on rescheduling for several months. Its standard norms required that rescheduled loans be classified in a risk category that carried a 20 percent provisioning requirement: the lender must set aside 20 percent of the outstanding value of the loan as a bad debt reserve. Under the amnesty, however, a rescheduled loan could be returned to the top risk category, as if it had never been late. BancoSol reported rescheduling $6 million and Caja los Andes $1 million during 1999. Further rescheduling was introduced as part of the government's economic revitalization program in early 2000. Although rescheduling is in some cases a realistic approach to clients with real debt service problems, its widespread use sends signals that can have a long term negative effect on repayment discipline. And regulations allowing rescheduled loans to be treated as on time give an overly rosy picture of the solvency of financial institutions. While none of the microlenders is experiencing delinquency at the levels that brought down the consumer lenders, their delinquency problems were more severe than suggested by the published figures (see below).

Microfinance in Crisis

After consumer credit vanished as quickly as it had come, it left behind a weakened microcredit industry. Liliana Bottega of Caja los Andes stated, "Acceso and CrediAgil have closed, but the damage has been done to the system. Who knows if it can recover?"The weakness in microfinance reveals itself in the loss of confidence by many of the actors in the industry. Four indicators help tell the story: the end of growth in numbers of clients, rising portfolios as microlenders go upmarket, the highest delinquency in the history of Bolivian microfinance, and a dramatic fall in profits. To the extent that the difficulties of this crisis result from economic downturn, these kinds of problems prevail throughout the Bolivian banking sector. Nevertheless, this is the first time the microlenders have experienced such stress.

During 1999 and 2000, none of the microlenders recorded the sizeable client growth rates of the past. BancoSol lost 25 percent of its clients and Prodem lost 45 percent during those two years. These two microfinance leaders had a combined total of 129,000 at year-end 1998, and only 87,000 by year-end 2000. It is presumed that much of this reduction represents elimination of clients with loans from multiple institutions. Caja los Andes among the regulated microlenders continued adding clients, increasing active clients by 31 percent during the two-year period, from 32,482 to 42,643. To achieve this growth, however, Los Andes had to work much harder than previously, because a larger share of old clients left, and a larger share of new applicants failed to qualify. The new FFP, Eco Futuro, also added clients, but most of its growth may result from transfers of existing clients from the four NGOs that formed Eco Futuro as part of the process of setting up the FFP.

Every microfinance lender experienced unprecedented delinquency during 1999 which continued into 2000. At the end of 1997, the regulated microlenders had only 2.4 percent of their portfolio overdue. This rate rose steadily, reaching 11.2 percent by year-end 1999. Although the increase continued in 2000, the alarming pace slowed, with delinquency reaching 12.6 percent by year-end.[17] However, it is important to note again that these figures do not include rescheduled loans.

The slower growth and higher delinquency showed up immediately on the bottom lines of all the microlenders. BancoSol's return on equity dropped from 29 percent in 1998 to 9 percent in 1999 and 4 percent in 2000. Fassil's profits dropped from 12 percent in 1998 to 1 percent in 1999 and into the negative range in 2000. Caja los Andes, the least affected by the crisis, managed to keep its return on equity at a respectable 14 percent, making it the third most profitable financial institution (including banks) in Bolivia in 2000.

Table 3: Indicators of Financial Performance for Leading Bolivian MFIs, December 1997-December 2000

	1997	1998	1999	2000
BancoSol				
Loans outstanding (No.)	76,216	81,555	73,073	60,976
Loans outstanding (US$ million)	63.1	74.1	82.3	77.8
Portfolio at risk (>1 day, percent)	2.1	2.5	7.0	12.3
Return on equity (percent)	24	29	9	4
Average loan size (US$, rounded)	830	910	1,130	1,280
Caja los Andes				
Loans outstanding (No.)	27,876	32,482	36,815	42,643
Loans outstanding (US$ million)	20.4	28.6	35.9	46.8
Portfolio at risk (percent)	n/a	5.7	6.5	7.7
Return on equity (percent)	36	27	14	14
Average loan size (US$)	730	880	980	1,120
Prodem				
Loans outstanding (No.)	38,248	47,130	39,909	26,096
Loans outstanding (US$ million)	18.2	24.2	21.8	23.6
Portfolio at risk (percent)	0.7	5.6	7.0	4.8
Return on equity (percent)	25	22	3	1
Average loan size (US$)	480	510	550	900
FIE				
Loans outstanding (No.)	22,086	20,848	24,111	23,402
Loans outstanding (US$ million)	12.1	14.1	18.5	22.5
Portfolio at risk (percent)	n/a	1.5	6.2	7.9
Return on equity (percent)	n/a	32	8	10
Average loan size (US$)	550	680	770	960
Fassil (also includes consumer loans)				
Loans outstanding (No.)	19,257	35,000	27,461	23,493
Loans outstanding (US$ million)	15.0	21.7	18.2	15.4
Portfolio at risk (percent)	n/a	12.4	13.8	17.2
Return on equity (percent)	11	12	1	-10
Average loan size (US$)	780	620	660	660

Source: *Boletín Financiero: Microfinanzas.* Asofin, Cipame, and Finrural, (various issues); Boletín Informativo: Superintendencia de Banco y Entidades Financieras, Año 12 – N^{o} 149 (December 2000). n/a = not available.

[17] Author's calculation, based on: ASOFIN, CIPAME, and FINRURAL, "Microfinanzas," December 2000, pp. 21-22.

ISSUES FROM BOLIVIA'S EXPERIENCE

In the remainder of this paper, we reflect on Bolivian microfinance commercialization and its crisis by looking at four dimensions critical for the microfinance industry as a whole: the impact of lending competition on methodology, the dynamics of overlending, outreach to the poor, and the relationship between microfinance and consumer lending.

Competition's Impact on Methodology and Service Quality

Up to this point this chapter has focused on how difficult increased competition and commercialization have been for microfinance *institutions*. However, for most of the *clients* of microfinance, this same story is extremely positive. Commercialization and competition have brought lower prices, quicker and easier service, and a variety of new products to customers. They have allowed the number of customers to grow until access to credit is virtually universal for Bolivia's urban microentrepreneurs, and increasingly to those in secondary cities and market towns. In this way, competition is the culmination of the microfinance quest. This major victory should not be forgotten as the microfinance field struggles with the challenges commercialization poses.

The fundamental fact of increased competition in microfinance is that it alters the balance of power between lender and borrower. A Fassil loan officer stated the problem succinctly, "Before, the institution selected the clients. Now the client selects the institution." When clients have a choice of institutions, they move to the lenders that offer the best service and the best deal. This freedom of movement plays havoc with the established methods of microcredit. The microcredit methodologies in use throughout most of the 1990s sacrificed client convenience in order to minimize lender risk. Group guarantees, immediate follow-up of delinquency, frequent meetings, and small initial loan amounts all pose inconveniences to clients. But clients accept them if they have no alternative.

This pressure on methodologies is a general feature of increasing competition in microfinance, bringing benefits to clients such as faster services, higher quality, and lower prices. During the late 1990s, Bolivian microfinance interest rates dropped and clients began paying attention to small differences in interest rates from one lender to the next. Throughout the system, lenders strove to turn loans around faster, in hours rather than days or weeks. The Bolivian microfinance institutions are scrutinizing every aspect of their methodologies, and introducing new products, looking for ways to make themselves more attractive to clients. BancoSol, for example, increased its product range from two lending and two savings products at the end of 1997 to eight lending, four payment and two savings products in 2001.

One of the more interesting and perhaps far-reaching dynamics to emerge in Bolivia regarding methodology involves the interplay between group and individual lending. Solidarity group loans, pioneered in Bolivia by Prodem and BancoSol, require clients to put their own assets at risk for their colleagues. If groups go wrong, as they often do, clients can lose a great deal of time, not to mention added stress and financial loss, in repairing the situation. Village banking methods, like those of NGOs Pro Mujer and Crecer, are even less flexible. They tie the timing of a woman's access to credit together in a schedule with 30 or more other women and require weekly attendance at meetings.

Microfinance institutions recognize that most clients prefer individual loans. Directors and staff of Caja los Andes believe that individual lending gives Los Andes and FIE a tremendous market advantage over BancoSol and Prodem, for reasons long by IPC and shared by Claudio González Vega and other financial economists at Ohio State University. An advantage closely linked to individual lending, beyond the issues of client convenience, concerns loan size, according to IPC. Solidarity group loans begin with a formula for the first few loans, moving gradually to greater reliance on repayment capacity as the determinant of loan size. Caja los Andes uses repayment capacity from the start. Theoretically this means that Caja los Andes has traditionally been willing to offer new clients a significantly bigger initial loan than BancoSol and to increase loan size more quickly. As validation of their views about the market advantages of individual lending, IPC and Ohio State can point out the stronger performance of Caja los Andes relative to BancoSol and Prodem during the crisis, as noted above (see Table 3).

There is a general sense among staff of the MFIs that many clients are moving from solidarity group loan programs to those that offer individual loans. BancoSol's former managing director, Hermann Krützfeldt notes that in a recession the group mechanism may even augment risk. Krützfeldt explains that during normal times, when one person has problems the other members can help him out. However, in bad times when all members are weak, the need to help one member can be too much for the others. One drags the others down. They back up their observations by pointing out that the majority of BancoSol's delinquency since the crisis was concentrated in its solidarity portfolio. In financial economists' terms, they contend that group lending is a great way to deal with idiosyncratic risk, but not systematic risk. BancoSol's Mario Usnayo notes that when emphasis shifts to repayment capacity over group formation and repayment history, loan sizes diverge among group members, and it becomes harder to keep groups together.

BancoSol moved slowly to respond to the competitive challenge posed by individual lending. Krützfeldt reports that when the competition first increased, some people on the staff wanted to jettison solidarity group lending. However, market research showed a significant portion of clients who cannot or do not want to provide the tangible guarantees that individual lenders usually require. Market researcher Domingo Fabbri says that these clients use the credit history of their group essentially as a substitute form of equity on which to leverage larger loans. Krützfeldt ruled out any possibility that BancoSol would abandon solidarity group lending. Nevertheless, by mid-1999 BancoSol greatly expanded individual lending. It moved into competition with conventional lenders by raising its ceiling on individual loans from $30,000 to $100,000 and adopting loan appraisal methods from mainstream banks. Throughout this period, solidarity group loans remained the largest share of the portfolio, but that share was shrinking; by the end of 2000, BancoSol's solidarity group loan portfolio had decreased to 34 percent of the total portfolio though it still represented nearly two thirds (62 percent) of all active clients.

Village banking NGO Pro Mujer, also faced a challenge to the rigidity of its group methodology, and sought an effective response. It sought to enhance flexibility by increasing the use of client internal accounts in which clients can borrow from the pool of funds managed by the village bank itself. Such borrowing can happen at any time and with little paperwork. It also emphasizes the value clients place on maintaining membership in their groups and receiving health and social services information. However, Pro Mujer's main bulwark against competition was its attempt to segment the market. By aiming at clients who are too poor or inexperienced to qualify for loans at the commercial microlending institutions, Pro Mujer hoped to claim that market niche for its own. The difficulties with this strategy are that Pro Mujer does not have a proven method for selecting clients that are both excluded from other microfinance programs and able to service debt. Moreover, after a couple of Pro Mujer loans its clients qualify with other lenders—as witnessed by the fact that so many of its clients have loans from BancoSol and others. Thus, Pro Mujer's main targeting policy is its upper bound on loans, which has long been $1,000. If Pro Mujer narrows its market to those clients who cannot borrow from other lenders, however, it becomes harder for it to achieve financial viability.

Evidence shows individual lending driving out group lending in the Bolivian microfinance industry at large. In Bolivia, the ratio of individual to group loans has grown ever since Caja los Andes and FIE began making significant market inroads: in December 1997, individual loans made up 41 percent of the aggregate group, association, and individual microenterprise loan portfolio. Three years later (December 2000), they accounted for 78 percent.[18]

Unhealthy Competition: Overlending

Unquestionably, most microfinance clients benefit from the advent of competition. More people have access—virtually anyone in a city or town who wants a loan and has an enterprise (or a salary). They can choose who they deal with, and they can demand favorable terms. BancoSol's Domingo Fabbri says, "The new (microfinance) banks were schools for clients to learn, and once they learned, they began to seek better options." These benefits for the majority of clients are, or should be the main story about the arrival of competition. However, the good news is tempered by questions on two fronts: overindebtedness and mission drift.

Poaching clients from other institutions through the offer of larger loans has proven to be an extremely successful marketing technique in Bolivia, as elsewhere. And it has been shown repeatedly that clients are not good judges of their own debt capacity. Apparently, credit is like good food: when seated at the table in front of a feast, many of us eat too much and regret it later. Perhaps more experienced borrowers than Bolivian microentrepreneurs can learn to exercise restraint, but the fact that overborrowing occurs in many societies (and is, for example, a chronic problem in the United States) suggests a common trait of human nature. The truly unfortunate dynamic is that if overlenders lure clients away from more responsible lenders, the responsible lenders are virtually forced to follow suit. The pressure on a lender to lend more to keep good clients is nearly as irresistible as the client's desire to

[18] Author's calculation based on: ASOFIN, CIPAME, and FINRURAL, "Microfinanzas," December 2000, p. 31.

borrow more. Worse, if clients begin using one loan to pay off another, the game becomes, as Elizabeth Naba of FIE says, "Who collects first?"In short, the sector as a whole starts to become a giant Ponzi scheme. Although the microlenders feared what was happening, they could not escape the syndrome without assistance. They, too, overlent.

A tenet of microfinance is that loan sizes must match repayment capacity. But when offering larger loans becomes a marketing advantage, even the most principled lender is tempted to push beyond prudent limits. The market dynamics associated with overlending require a collective response, supported by regulatory standards. In such a situation, only a central body, like the Superintendency of Banks can stop the spiral, with regulations like those put in place for consumer loans in 1999. The problem of multiple loans requires top quality credit bureaus, while the problem of excessive loan sizes requires industrywide lending norms. In every country where microfinance is growing, credit bureau development should be high on the agenda, even if commercialization is some years away, as it takes time to perfect such systems. It will be crucial for microfinance in the future to find an effective solution to the overlending dynamic.[19]

The New Microfinance Industry and the Poor

Perhaps the greatest anxiety about the commercialization of microfinance is the fear that the introduction of the profit motive will cause microfinance institutions to move upmarket, away from the poor.

The starting point for considering this issue in Bolivia is the recognition that the commercially-oriented MFIs in Bolivia never served the extremely poor. As the financial economists of Ohio State University showed in their analysis of 1995 data, 78 percent of BancoSol clients clustered just below or just above the poverty line. Most of the remaining 22 percent were non-poor. At FIE and Caja los Andes, most clients were above the line (80 percent and 74 percent, respectively). Only 2 or 3 percent of the clients at any of these institutions were in the lowest categories, labeled indigent or poorest.[20] Of the institutions Ohio State studied, only the rural lenders Prodem and Sartawi served primarily people below the poverty line. In short, Bolivian urban microfinance reaches into the low income population but generally remains in the upper segment of the poor.

Average loan sizes have been increasing at all the leading commercial MFIs, as Table 3 shows. As early as 1994 BancoSol management began wondering about the upward trend the bank's loan sizes. In 1992 BancoSol's average loan balance was US$250. By 1995 this figure had doubled, and by the end of 2000 it was US$1276.[21] From the start, growing average loan sizes were inherent in the microcredit methodology. As client enterprises grew and as clients proved their trustworthiness as good repayers, long term customers would receive larger

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[20] Claudio González-Vega et al., "A Primer on Bolivian Experiences in Microfinance: An Ohio State Perspective" (Columbus, Ohio: Rural Finance Program, The Ohio State University, no date), 26.
[21] González-Vega et al., "Primer," 23; Banco Solidario, "Memoria 1998"(La Paz, 1999), 112, and ASOFIN, CIPAME, and FINRURAL, "Microfinanzas" December 2000.

loans. As more and more long term customers stayed with BancoSol, its average loan size would rise. Also, as mentioned above, the introduction of new, larger-size loan products has added to the increase in average loan size. None of these trends is in itself a sign of mission drift. Mission drift would occur if the organization stopped lending to new clients at the low end or failed to retain existing low-end clients. But it has been hard to tell how much the observed increase in average loan size came from a worrisome move away from the traditional client base. As regional manager German Sanchéz noted, when loan officers know that larger loans are more profitable they are naturally tempted to pursue larger clients, especially when trying to meet portfolio and income targets. Pancho Otero, BancoSol's first managing director, recalls the wariness about loan size creep. "There's no problem making larger loans to more successful clients, even individual loans. The difficulty is to stay excited about the smaller clients."

BancoSol began a more detailed analysis to get at the story behind the numbers. ACCION staff member Jean Steege pulled the portfolio apart, looking at loans in separate cohorts. Her study concluded that most of the growth was coming from repeat clients and not mission drift. Ohio State University, in a study of BancoSol and four other leading microfinance lenders, concurred. "There is no evidence of drift from the organizations' mission of lending to the poor, even though the average size of loan has grown as their portfolios have matured."In fact, the study found that Caja los Andes was actually moving down-market during this period as it opened its doors increasingly to market vendors.[22]

Five years later, in 2000, available numbers indicate that the commercial microlenders remain very active at the bottom end of the spectrum (see Table 4). In fact, the institution in Bolivia with the largest portfolio of loans below $500 was Caja los Andes, by a wide margin. The small loan portfolios of other commercial microlenders were similar in size to those of the largest NGOs. Although it is possible that the NGOs reach down farther within the under $500 category, data is not readily available to investigate at that level of detail. Meanwhile, the distribution of loans under $500 across institutions offers important reassurance about the continued importance of commercialized institutions in reaching downmarket.

Table 4: Institutions with Largest Portfolio in Loans Below $500 (in US dollars)

Institution	Portfolio (millions)
Commercial MFIs	
Caja los Andes	5.0
FIE	3.0
BancoSol	2.4
Eco Futuro	2.1
Prodem	1.6
NGOs	
Crecer	3.3
Pro Mujer	2.8
FADES	2.7
ANED	2.5

Source: Asofin, Cipame, and Finrural, *Boletin Financiero: Microfinanzas*. December 2000, pp. 36-37.

[22] González-Vega et al., "Primer," 22.

Competition undoubtedly places pressure on the arithmetic of break-even loan size. Steege's research had examined the relationship between loan size and profitability by identifying the break-even loan size for BancoSol. This closely guarded number quantified what staff at microfinance institutions already knew intuitively: small loans lost money and were cross-subsidized by larger loans. For clients who start small and grow, the overall client relationship is profitable, but for clients whose loan sizes stay small—or who leave the bank after a first or second loan—it is not. During the pre-competitive years, this observation did not pose a problem. Rather, it underscored the importance of turning every customer into a repeat customer, a core principle throughout all service industries.

The pure commercial entrants, both consumer lenders and others, entered the market at the upper end, presumably at loan sizes near or above their own break-even sizes. They are unlikely to cross-subsidize even temporarily. And if clients begin jumping from lender to lender, they might abandon a particular institution just when they reach the break-even loan size.

If commercially-driven lenders take over a major share of top end of the microfinance market, they leave the mission-driven organizations, whether commercialized or not, with some unpleasant choices. In order to remain competitive, mission-driven organizations may have to reduce cross-subsidization so as to offer the upper end clients better terms. Alternatively, they may be left with a client group whose loans are too small to be a basis for profitable operation, as may be the case for Pro Mujer. Perhaps much of this dilemma could be solved simply, through differential pricing to boost the smallest loans above the break-even threshold. Differential pricing is already in place in FIE and some other organizations.

BancoSol has decided to enter a more upscale market, but senior managers argue that this involves the addition of new markets, not subtraction from their original focus. The poverty-focused lenders like Pro Mujer face a starker choice than BancoSol. Pro Mujer has decided to remain with its original focus, but finds that this choice may threaten its ability to keep its larger clients and become financially viable because of the cost factors associated with smaller loans. One result of Pro Mujer's choice to remain a poverty-focused NGO is that it will be able to retain access to the donor funding which is increasingly aimed at the very poor. Such access could become essential if competition continues to bite into the upper portion of Pro Mujer's target group.

In Bolivia generally, intense competition is giving institutions a great incentive to seek new, less saturated market niches. Some observers believe that this force will lead to innovations that make smaller loans profitable. This long run push toward new markets could mean that competition will ultimately result in deeper outreach toward the poor. But for the future, gains for the very poor are likely to come from the move of microfinance into rural areas and from their development of specially tailored savings services. recognizing the potential anti-poverty impact of these services, donors in Bolivia are now focusing their attention and funding on innovation in rural lending and on savings.

Consumer Lenders and the Public Identity of Microfinance

In many countries throughout South America, in South Africa, and soon perhaps, elsewhere, microfinance institutions must come to grips with the consumer lending challenge. Despite the debacle it suffered in Bolivia, consumer lending is a rapidly growing phenomenon. Microfinance lenders operating where consumer lenders are growing fast must face an extremely awkward fact: from the client's perspective, their product looks very similar to the product of lenders often considered unscrupulous. In Bolivia, the consumer and microfinance lenders provided loans with similar terms (size range, duration, interest rate) with a similar quick turnaround (a few days) and with similar rhetoric about the benefits to the client (growth and prosperity). The borrowers' revolt demonstrated how thin the line is between microfinance, which has always aimed to be helping people, and consumer lending, a purely profit-seeking activity. The debt protesters did not greatly distinguish between them.

In light of the strong overlap in clientele between consumer lenders and microfinance, a nervous joke is beginning to circulate among staff of microfinance institutions: that microcredit will ultimately reduce to little more than a few lines on a bank loan application form. Microfinance's unique contribution has been its ability to lend to the self-employed—families without secure salaries that can serve as the basis of more conventional lending. Perhaps one day soon the special needs of microenterprises will be taken care of by a brief analysis of the repayment capacity of the microbusiness in the context of a generic small loan product. Microfinance institutions have always defined themselves by their focus on poor clients outside the formal economy. However, in countries where the middle class is growing, fewer households lie completely outside the circle of formal employment. And Bolivia raises the possibility that as information technologies and lending methodologies progress, consumer lenders may become increasingly able to serve microenterprises. The borrower revolt and the very real overlap between consumer lending and microcredit should provoke microfinance practitioners and the donors who support them to serious rethinking.

One line of rethinking concerns the public image of microfinance and the values it represents. What actually distinguishes lending that is good for the client from destructive lending? If the private sector contains unscrupulous elements, how should the microfinance industry position itself? The Bolivian experience suggests that the principal public image issues for microfinance are high interest rates and the consequences of default—age-old concerns about moneylending. It is ironic that the Bolivian debtors associations played the interest rate card, despite the facts that rates had never before been at issue between microlenders and their clients and that rates were declining under competition.

Money lending has a bad reputation in part because it is associated with leading people into debt addiction. One reason microfinance has been so zealous in maintaining low delinquency is to ensure that its borrowers can handle their debt. A few defaults are necessary to create object lessons, but not the seven to ten percent of clients the consumer lenders considered routine. Bolivia's consumer lenders tolerated a level of default that the microlenders considered unconscionable because of its toll in broken families and because other borrowers had to pay for those failures. Microfinance needs to define clearly what lending practices are good for clients, recognizing that the human weakness for fast cash may make a purely market-based solution less than ideal. The burden is on the microfinance profession to define and promote good, ethical practice in an effective way.

Another line of rethinking concerns future directions for those concerned with getting finance to the poor. Should microfinance expand its scope to include financial services for the low income salaried sector? Many salaried employees in poor countries receive incomes as low or lower than microentrepreneurs. The microfinance profession has seen a burgeoning interest in new product development, recognizing the variety of financial needs of the poor, including savings, housing finance, and insurance. In the process of exploring such new products, should microfinance focus exclusively on the non-salaried segment of the population, on the grounds that the market will not provide for this segment, or should it be all-inclusive, on the grounds that the same product can serve both segments? In part, this is an empirical question: as financial innovation progresses, it may or may not turn out that the salaried/non-salaried distinction remains relevant for selecting clients. The microfinance institutions will have to make their choices in a way that keeps them viable in a competitive market, while the providers of subsidies to microfinance will have to direct public funds toward populations and products the market will not reach.

The commercialization of microfinance raises an interesting analogy to organic farming. Both microfinance and organic farming started as revolutionary movements radically critical of mainstream practices. They gradually developed their own techniques to a level that attracted commercial operators. In organic farming, some large food processing and supermarket corporations have started organic divisions and most food companies appropriate the rhetoric of purity that surrounds organic products. The involvement of commercial players has sparked intense controversy within the organic movement. An organic industry analyst put the dilemma this way: "Is this about getting better food grown in an environmental way to the most people possible, or is it about creating an alternative food system that is small, local and sensitive to issues like social justice?"[23] Substitute finance for food and poverty for social justice, and the voice could come from microcredit.

Those in the microfinance field for whom poverty alleviation and empowerment are central profoundly distrust the private sector. They fear that the private sector will take up the vehicle but not the values. Once commercialization begins, however, the bare truth appears that utopian microfinance institutions—like organic farms—cannot shut themselves off in isolation. The prudent course is to work with the private entrants to ensure that they adopt the values and practices the promoters of microfinance endorse. Like it or not, as the example of Bolivia shows, the future of microfinance requires engagement with the mainstream.

REFLECTIONS

The Bolivian experience has offered an early chance to examine commercial microfinance. In reflecting on that experience it is important to separate commercialization from the crisis, noting that some aspects of commercialization in Bolivia had little to do with the crisis.

[23] *New York Times,* April 9, 2000, BU 10.

Regarding commercialization itself, two points stand out. First, the commercialization of microfinance in Bolivia has largely followed one particular path—the transformation of NGOs into financial institutions. Other models, such as downscaling of banks and financial institutions and creation of new commercial entities are also relevant in some countries. Pure private entry into microenterprise lending, while present, has not been dominant, and the crisis has ensured that it is unlikely to be a major factor for some time to come. So we look to Bolivia as one important variation in the overall commercialization story, but not the whole story.

Second, it is important to reiterate the effects of commercialization on service quality, methodology, and new product development and to emphasize that these emerged largely separately from the crisis. These far-reaching and mainly positive results will not necessarily be accompanied by the kind of crisis Bolivian microfinance has faced. Indeed, studying the Bolivian example may help policy makers and lenders achieve the positive results without falling victim to the negative ones.

But neither can one simply set aside the crisis as an unfortunate confluence of events unique to Bolivia. Perhaps the arrival of economic and political problems in Bolivia at just the time when the lenders had overextended themselves was bad luck. But this kind of bad luck is characteristic of collective financial behavior: the extent of the risk a system has taken on is only revealed when an economic downturn arrives. Also perhaps the behavior of the Bolivian consumer lenders and to a lesser degree the response of its microlenders was just poor judgment. But those judgments sprang from motivations and conceptual paradigms that are widely prevailing among consumer and microenterprise lenders in many countries. Although we may not see as dramatic a series of events in other places as in Bolivia, it is almost certain that some of the underlying patterns will be part of the future of commercialized microfinance.