

THE EVOLUTION OF MICROFINANCE IN BOLIVIA: A COMMERCIALIZED INDUSTRY

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ABSTRACT

As the microfinance industry has grown into a worldwide development, many different strategies and lending technologies have surfaced. With a focus on sustainable and profitable operations, the commercialization trend has taken over much of Latin America. This paper examines the impacts of, and the motivations and methods behind the commercialization process by exploring the highly commercialized microfinance industry in Bolivia. The Bolivian case study demonstrates how the commercialization of the microfinance industry in that country has expanded outreach, increased efficiency and created a competitive industry that integrates the informal population into the formal banking system. With strong institutions and a solid regulatory framework, financial sector development is the primary benefit of a commercialized industry. Although poverty alleviation is not the principal objective of the Bolivian microfinance sector, the numerous positive aspects of the country's model should be given merit.

Keywords: Microfinance; Bolivia; Commercialization; Financial sector development

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1: INTRODUCTION

Microfinance is a financial strategy, increasingly popular within the international development community, which strives to alleviate poverty and strengthen the financial systems of developing countries by providing credit and other financial services to the low-income population. Impoverished populations all over the world need financial services for the same reasons as their more affluent counterparts: to start a business, cope with an emergency or improve their home. However, since the poor frequently lack collateral and steady income, formal banking is often not an option; even informal lending is not an efficient alternative due to the usurious interest rates typically charged. In order to address this market failure, microfinance institutions have emerged. By providing credit to those excluded by the formal sector, microfinance institutions fund productive activities that promote income growth and support small business investment (Morduch, 2000).

Muhammad Yunus of Bangladesh pioneered the microfinance industry in the late 1970s by establishing the first institution, the Grameen Bank. With the overarching goal of poverty alleviation, Grameen utilizes a group-lending scheme specifically tailored to meet the needs of the poorest of the poor. Currently, Grameen Bank serves over 8 million borrowers (typically rural women) and boasts a 97% repayment rate (Grameen Bank, 2010). Inevitably, the lending technology put forth by Yunus has had great success and has become a model

for many countries (Ledgerwood, 2002). Indeed, microfinance has found a way to cope with the risks associated with lending to low-income clients who lack collateral. This breakthrough challenges entrenched views that poor people are not creditworthy individuals (Sengupta and Aubuchon, 2008).

Due to the success of the original model, microfinance institutions have proliferated worldwide. Estimates reveal the existence of over 7000 institutions in 65 countries, serving almost 80 million people (UNDESA, 2008). The growth of this sector has given rise to a range of different models and techniques, some vastly different from those of Grameen Bank. Traditionally, microfinance services have been provided primarily through non-governmental organizations (NGOs). More recently, however, some donor funded NGOs have been unable to sufficiently supply the growing demand for microcredit;¹ as a result, many institutions have looked to the commercial sector to accommodate expansion of the industry (Bell, 2006). In fact, the commercial approach to microfinance dominates much of Latin America;² as an alternative to the original model, commercial institutions focus on providing microloans to the low-income population through sustainable and profitable operations. Since commercialization is both new and different, the methodology is not broadly accepted within the development world as a tool for poverty alleviation.³ In an effort to better understand the motivations and methodology behind commercialization as well as its impact on the financial sector, this study seeks to

¹ Microloans or microcredit refer specifically to loans whereas microfinance includes options such as insurance and remittance services.

² See for example CGAP, 2001; Barzelay, 2008; Berger et al., 2006.

³ See for example Barzelay, 2008; Hishigsuren, 2007.

analyze the evolution of microfinance in Bolivia. Bolivia features one of the most advanced microfinance industries in the world and is home to the world's first commercialized institution.⁴ Microfinance has played an important role in the Bolivian economy as 60% of the population lives below the poverty line and is excluded from the formal banking sector (Prensa Latina, 2010). In fact, microfinance institutions in Bolivia serve over 70% of clients in the banking sector (PROFIN, 2007). Therefore, Bolivia provides a useful case study as it demonstrates that poor countries have the ability to attain a developed and innovative microfinance industry to serve the low-income population. Moreover, as a pioneer of the commercialization trend, the case of Bolivia is instructive for other Latin American countries following a similar path or aiming to strengthen and to diversify their financial sectors.

This paper will argue that the economic and political situation that coincided with the onset of microfinance in Bolivia created an encouraging environment for a commercialized industry to thrive. As such, the Bolivian model of microfinance has promoted the development of the financial sector by building and strengthening banking institutions and regulations. Furthermore, commercialization has provoked competition which has sparked more efficient operations, lower costs and new products, providing more options and opportunities for the low-income client. Thus, although microfinance in Bolivia has been geared towards commercialization and financial sector growth as opposed to poverty alleviation, the industry that has evolved provides better

⁴ See for example Gonzalez-Vega et al., 1997; Navajas and Schreiner, 1998; Berger et al., 2006.

opportunities to the impoverished population and integrates them into an advanced formal banking sector.

Accordingly, this study will begin by providing a brief summary of the overall effects of microfinance in Bolivia; this portion will look at poverty alleviation, the informal sector and outreach. In addition, the lessons that Bolivia's experience could lend to other developing countries and the potential influence that the current Bolivian government may have over the industry will be considered. The next section will examine the origins of microfinance in Bolivia to provide a contextual background as to how and why the industry began. The following discussion will look at the specific characteristics of the Bolivian model of microfinance. After that, some of the impacts of a commercialized industry will be explored. The final section will conclude.

2: OVERVIEW: MICROFINANCE IN BOLIVIA

Microfinance in Bolivia has evolved beyond a donor-driven movement, into a complex and dynamic industry. With strong institutions, high profitability and international support, microfinance in Bolivia is arguably the most successful and well-known industry in the world besides Bangladesh. Indeed, the sector began under different pretences than the original Grameen model; instead of striving to reduce poverty, microfinance in Bolivia was premised on employing a growing informal sector and helping to rebuild the country's damaged financial system after an economic crisis in the 1980s. As the economic situation in Bolivia improved, international organizations encouraged microfinance institutions to commercialize and take advantage of the country's unique circumstances. With government support, technical expertise and densely populated urban regions, the microfinance institutions in Bolivia created their own methodology to coincide with their specific objectives; as such, a commercialized microfinance industry was born. Before examining the intricacies of the Bolivian case, it is perhaps useful to look at some of the overall effects of the microfinance industry, the possibility of replication in other countries and the current government's role in the industry's future.

2.1 Effects of Microfinance

According to the Jubilee Foundation,⁵ the current rate of poverty in Bolivia (i.e. about 60%) is the lowest the country has seen in the last ten years (Prensa Latina, 2010). Within the same report, the Economic and Social Policy Analysis Unit (UDAPE)⁶ stated that the moderate poverty rate (i.e. living on less than \$2 per day) in Bolivia has decreased from 66.4% in 2000 to 59.3% in 2008.

Apparently, the downward trend is attributable to several development policies initiated over the past decade.⁷ However, it is also likely that the 3.6% average annual growth (real GDP) rate, which the Bolivian economy experienced throughout the same time period, has also contributed to poverty alleviation (CIA World Factbook, 2010). On the other hand, the World Bank (2010) asserts that the poverty headcount ratio in Bolivia at the national poverty line was 63.2% in 1997 and decreased to 37.7% in 2007.⁸ This estimation indicates a much larger decline in poverty rates than the previous report. As there are many different methods to account for poverty levels, estimations will vary. Nevertheless, each of the sources mentioned seem to agree that poverty in Bolivia is decreasing; yet, Bolivia remains one of the poorest countries in the region. Moreover, the country still lags on several measures of development such infant mortality and life expectancy. Chronic malnutrition and anaemia continue to persist in small children (CERF, 2010). Conversely, literacy rates have improved, reaching over

⁵ The Jubilee Foundation is an international NGO that seeks to alleviate poverty by supporting sustainable projects in the developing world.

⁶ UDAPE is affiliated with The United Nations Children's Fund (UNICEF).

⁷ Specific policies were not mentioned in the report.

⁸ Please note that the World Bank does not provide poverty rates for Bolivia on their website beyond 2007.

90% in 2007 (World Bank, 2010). Regardless of the indicator or measurement used, poverty is a complex issue which makes it difficult to determine exactly how microfinance has affected the lives of those who participated. As previously mentioned, microfinance in Bolivia has been used as more of a vehicle for microenterprise growth rather than as a developmental tool to alleviate poverty. Thus, any reduction in poverty would simply be an added bonus to the true goal of informal sector employment. Furthermore, several studies argue that the financial sector in Bolivia is too small to have an impact on poverty alleviation or economic growth.⁹ It follows that if the entire financial system is considered an insufficient source of growth, the microfinance component of that sector would be inadequate as well. However, one study suggests that the microfinance industry in Bolivia could contribute to financial deepening by continuing to broaden the base of both borrowers and savers (Morales, 2007). Therefore, while microfinance may have positive impacts on poverty and development, it is unlikely to be a panacea for growth at this time. Still, the microfinance industry in Bolivia does provide several benefits to the country which will be discussed throughout this study.

Furthermore, the microfinance movement in Bolivia has altered and enhanced the informal sector. Like other developing countries, much of the economic activity that takes place in Bolivia is in the informal segment (Marconi and Mosley, 2006). Even so, prior to the 1990s, this sector was seen as a transitional part of the economy. As the microfinance industry emerged, however,

⁹ See for example Svensson, 2007; Rhyne, 2001a; Morales, 2007.

there was a paradigm shift. Indeed, microfinance institutions in Bolivia target the informal population and thus encourage growth and development of the sector as they provide loans to microentrepreneurs. As such, the informal sector in Bolivia has expanded and progressed, and microenterprise is now thought of as being more of a business and contribution to society than originally thought (Berger, 2000). Therefore, the credit opportunities supplied by the microfinance industry have instigated a positive shift in the economic position of microentrepreneurs, which has subsequently led to an improved and empowered informal sector.

Additionally, microfinance in Bolivia has resulted in an immense level of outreach and market penetration. In fact, Rhyne and Otero (2006) predict that the majority of the low-income population will have access to financial services within the next decade, and through this revolution, the microfinance sector will become a standard segment of the country's financial system. As the urban market has been virtually saturated, competitive forces will likely shift the focus to rural areas. Thus, the very poor rural Bolivians will potentially be the upcoming market of microfinance institutions in the country. Some observers believe that a shift in focus "will lead to innovations that make smaller loans [more] profitable" (Rhyne, 2001b). Indeed, increasing the profitability of small-scale loans would entice larger institutions to enter the rural market. Moreover, providing loans to the very poor increases the depth of outreach for microfinance institutions; as such, the possibility of poverty alleviation is amplified, which is ultimately a positive asset. Therefore, while the economic impacts of the microfinance industry in Bolivia are

difficult to determine, the sector has contributed to a more empowered and integrated society.

2.2 Is Replication Possible?

Since microfinance has grown into an advanced and profitable industry in Bolivia, the country's experience may be useful for other institutions around the world. While certain aspects of the Bolivian model have the potential to translate to other countries, there are a few initial circumstances that would be difficult to mirror. For instance, three factors that widely contributed to Bolivia's success were the political environment, international support and the explosion of informal sector demand for credit. Early on, microfinance institutions in Bolivia had a working relationship with the government while the regulatory framework was in the midst of being developed. In addition, international organizations provided a few institutions in Bolivia with financial support and technical expertise; through this assistance, the institutions were able to achieve great success, innovation and profitability. Meanwhile, the growing informal sector supplied the microfinance industry with plenty of clients in need of credit. Essentially, the microfinance sector in Bolivia was a collaboration of several positive and influential forces, which culminated in a booming industry. While it may be possible to attain political and international support, informal sector demand would be much harder for a country to generate. Although the specific combination of factors that led to Bolivia's success would be difficult to reproduce, it is important to note the role that was played by the specific contextual elements within Bolivia in the development of their microfinance

industry. Thus, even though microfinance institutions worldwide may not be able to emulate the circumstances in Bolivia, they may take a deeper look at their country's own conditions and try to more fully utilize their current position.

Surely, Bolivia's experience with microfinance does offer a few additional lessons that other countries could learn from. Foremost, the unique lending technologies and business models of some of the strongest institutions in Bolivia could certainly provide a guide for a less developed industry. Bolivia's experience illustrates how sustainable, innovative and competitive operations can increase profits while lowering costs for clients. As such, the innovations and experiments that microfinance institutions have utilized in order to perfect the Bolivian model could benefit microfinance on a global level, thus creating a more efficient and effective industry. Furthermore, as a pioneer of commercialization, Bolivia's experience demonstrates that NGO status is no longer the final step for microfinance institutions (Rhyne, 2001a). The overwhelming existence of financial sustainability and independent sources of funding has largely replaced the traditional nature of non-profit institutions. Undeniably, the commercialization trend has already taken over much of Latin America. While defining a best practice for all microfinance institutions presents many challenges, overall themes within Bolivia's experience have the potential to educate and positively impact less advanced industries around the world.

2.3 New Government Influence

Since the microfinance industry in Bolivia commenced about twenty-five years ago, the institutions have been met with exceptional government support.

However, when Evo Morales assumed the Presidency in 2006, his strong anti-neoliberal stance was perceived as a threat to the highly commercialized microfinance sector.

From the beginning, Morales has been clear about his vision for social change in Bolivia. In fact, his ideology opposes the for-profit status of microfinance institutions; to the left-leaning President, profits imply that costs to clients could be lower and are also indicative of the “neoliberal economic policies that have failed to lift the majority of Bolivian citizens out of poverty” (Loehrer, 2008). As most of the microfinance institutions in Bolivia strive for financial sustainability and profit generation, the President’s position on the matter has caused some concern. Without a doubt, more stringent regulations would affect microfinance institutions; these changes would then filter down, affecting clients as well. Despite his view, Morales continues to assure the microfinance industry that government interference in the financial sector will be kept to a minimum (Loehrer, 2008). Indeed, any radical action taken by the government could result in another financial crisis, which could lead to devastating consequences for the highly vulnerable and vastly impoverished population in Bolivia. Since microfinance institutions specifically target low-income clients, it seems likely that the President’s social orientation would cause him to have a particular interest in protecting the sector’s clients. Thus, drastic government intervention in the microfinance industry appears doubtful at this time, especially considering the success that the industry has seen.

Still, the Morales administration does recognize the prevalence of microfinance in Bolivia and has initiated a few projects. For instance, in 2007, Morales launched a second-tier development bank, Banco de Desarrollo Productivo¹⁰ (BDP), charged with promoting the productive sector through the assistance of microfinance institutions. In other words, BDP is a financial intermediary between institutions and clients; with a focus on industries such as agriculture, BDP provides cheap funding to microfinance institutions, which then make loans to appropriate customers. However, the majority of the organizations within the microfinance sector in Bolivia chose not to engage with BDP as the bank forbids institutions from charging interest rates over 6%; many leaders of the industry feared that such low rates would not cover costs and thus would cause institutions to lose money on loans (EIU, 2009). So, due to the strict requirements associated with funding, BDP made little impact within the microfinance industry. The Morales administration is also in the process of working with the Superintendency¹¹ to create an additional regulatory category for microfinance organizations. The new regulation will allow NGOs to accept deposits without becoming for-profit institutions. This will enable socially oriented organizations to retain their non-profit status while expanding their services. Moreover, NGOs will be able to take advantage of savings mobilization, which will potentially increase outreach. It seems that Morales has found a way to contribute to microfinance in a way that suits his social objectives.

¹⁰ This translates into 'Productive Development Bank' in English.

¹¹ This is the governing body over financial institutions in Bolivia that will be discussed in more detail in a later section.

As of now, the microfinance industry has been unhindered by the new economic policies enlisted by the current administration; in fact, the sector continues to grow. Nevertheless, microfinance institutions remain fearful of potential policies such as a cap on interest rates (Loehrer, 2008); clearly, BDPs experience with limiting rates reveals that profit oriented institutions do not respond well to this tactic.

In short, the Bolivian microfinance industry has empowered the informal sector and will likely begin to target the rural population; this development would have the potential to positively impact poverty alleviation in the future. Although economic development and poverty reduction are difficult to attribute specifically to microfinance institutions, the booming industry in Bolivia has likely added value to the country's economy. Moreover, Bolivia's experience lends guidance and direction to other nations attempting to build-up their microfinance industry. The next section will uncover the roots of microfinance in Bolivia.

3: ROOTS OF MICROFINANCE IN BOLIVIA

In order to understand how the microfinance industry in Bolivia has evolved, it is necessary to examine the unique combination of circumstances that preceded the emergence of the sector. Firstly, the economic situation, or initial conditions, in Bolivia that created a promising environment for microfinance to flourish will be detailed. Following that, the international organizations that heavily influenced the Bolivian microfinance industry will be assessed.

3.1 Initial Conditions

Bolivia is one of the poorest countries in Latin America and has one of the highest levels of income inequality in the region (Paes de Barros et al., 2008). Consequently, from the 1950s to the early 1980s, several administrations had attempted to improve the economic situation in Bolivia and lift the poor out of poverty. For example, in 1952, the Movimiento Nacionalista Revolucionario (MNR)¹² led a revolution that sought to expand political and economic power beyond the small group of elites that had ruled the country since independence. Paz Estenssoro was president of the MNR at this time. During the revolution, Estenssoro and the MNR instituted a land distribution program and nationalized tin mining companies; thereafter, successive administrations employed widespread controls over key prices and rates (i.e. interest, exchange). Although

¹² This translates into 'Nationalist Revolutionary Movement' in English.

the intention was to improve the circumstances in Bolivia, the measures were unsuccessful and the economy slowly declined (Rhyne, 2001a).

By the early 1980s, Bolivia had experienced six consecutive years of negative economic growth and had a rising public sector deficit. “As a direct consequence of the decision to finance this deficit with the help of the printing press, [Bolivia suffered from] one of the great hyperinflations of modern times, reaching its peak at an annual rate of 24,000 per cent” (Mosley, 2001). The financial crisis and recession that ensued forced the public sector to lay off many employees. Meanwhile, international tin prices fell dramatically, provoking a further crisis in the mining sector which left 24% of the labour force jobless (Rhyne, 2001a). At this point, pervasive rural poverty in concert with widespread unemployment triggered a massive rural to urban migration (Gonzalez, 2005). Evidently, rural migrants hoped to find employment in the urban cities. However, the majority of the migrants were pushed into the informal sector as the formal economy was on the verge of collapse. Self-employment rates rose as job opportunities were difficult to attain; as a result, demand for financial services sharply increased (Rhyne, 2001a).

By 1983, the informal sector employed 60% of the Bolivian population, the majority of which were microentrepreneurs (World Bank, 1996). Consequently, this created a large pool of prospective clients for microfinance institutions, which typically target self-employed individuals. Moreover, the high urban population density that resulted from the mass migration, produced a situation where institutions could reach a large number of clients at low cost (Mosley, 2001).

Informal sector growth coupled with the rising demand for financial services and densely populated urban regions created a promising environment for microfinance. It seems likely that these initial factors explain why the majority of the microfinance institutions in Bolivia specifically target the urban population. Targeting urban borrowers is contrary to the original Grameen model, which focuses strictly on the rural poor. As poverty is generally more extreme in rural areas, targeting the urban population is a debated topic in microfinance literature;¹³ however, the situation that presented itself in Bolivia warranted the approach.

In 1985, a new government came into power charged with stabilizing the Bolivian economy and restoring faith in the financial sector. To cope with the severe hyperinflation, high unemployment and mounting economic turmoil, the administration pursued a stabilization program known as 'New Economic Policy'. Although the microfinance industry in Bolivia had yet to commence operations, several of the measures adopted under the reform package were nonetheless beneficial for the forthcoming sector. For example, the reform policy initiated sound macroeconomic policies in order to control inflation; monetary and fiscal policies were tightened and interest rates, which were previously set by the government, were liberalized. As a result, inflation decreased to 9% by 1986, and shortly thereafter, the Bolivian economy experienced growth (Sachs, 2001). Economic stability and free market principles are two additional factors that facilitated the emergence of microfinance in Bolivia. Specifically, after interest

¹³ See for example Schicks, 2007; Conning, 1999.

rates were liberalized, there was no longer a maximum rate of interest that financial institutions were allowed to charge (Trigo Loubière et al., 2004); this is particularly important for a commercialized microfinance industry as financial sustainability is dependent on the freedom to charge an interest rate that will cover costs.

As well, under the New Economic Policy, the government liquidated bankrupt and ineffective state and private banks. Consequently, very few banks remained after the financial crisis. Yet, even before hyperinflation plagued the Bolivian economy, the banking system was inefficient and unable to reach small-scale borrowers; without previous success of serving low-income clients, the banks that survived the crisis were reluctant to experiment with providing the risky and expensive services (Mosley, 2001). Conversely, microfinance institutions represented a practical option to accommodate this gap in the market. At this time, an international organization that specialized in microfinance, Acción International,¹⁴ introduced the concept to several influential Bolivian executives, politicians and activists. Microcredit epitomized a viable and socially conscious approach to “the great income distribution divide” that afflicts the Bolivian economy (Rhyne, 2001a). Moreover, because only a few banks endured the recent financial crisis, competition was virtually nonexistent, thus encouraging microfinance institutions to enter the banking sector. With the knowledge and influence of local parties, and the guidance and support of a few international

¹⁴ Details about this organization will be discussed in the following section.

organizations, microfinance would soon become a part of Bolivia's financial system.

In addition to eliminating poorly performing banks, the reform program modernized the banking framework in Bolivia; new banking legislation was enacted in 1993, charged with the prevention of a future financial crisis (Rhyne, 2001a). To this end, the legislation strengthened the Superintendency of Banks, which is the entity responsible for financial sector oversight. The improved legal framework created an environment under which microfinance institutions could operate with confidence.

Therefore, during the mid-1980s, the Bolivian economy was comprised of a specific combination of circumstances that stood to benefit from a microfinance sector. The financial crisis prompted unemployment and a mass migration, generating a large and concentrated demand for microfinance services; indeed, the microfinance industry in Bolivia was premised on employing this urban and informal population. In addition, the economic situation that followed the crisis contained many favourable conditions for the supply of microfinance services; liberalized interest rates, economic stability, insignificant competition and an improved banking sector framework are all factors that helped facilitate an advanced microfinance industry in Bolivia. The following section will expand on the international support behind the industry.

3.2 International Organizations

Although cooperatives in Bolivia have been lending to microentrepreneurs since the 1960s, microfinance institutions were the first to develop efficient and effective lending technologies that resulted in financially sustainable organizations. In the mid-1980s, two international organizations with substantial experience in microfinance came into the scene, took advantage of the economic situation in Bolivia and effectively shaped the industry. Inevitably, there are additional organizations involved with microfinance institutions in Bolivia;¹⁵ however, the two organizations described below were highly influential in creating a vastly commercialized sector.

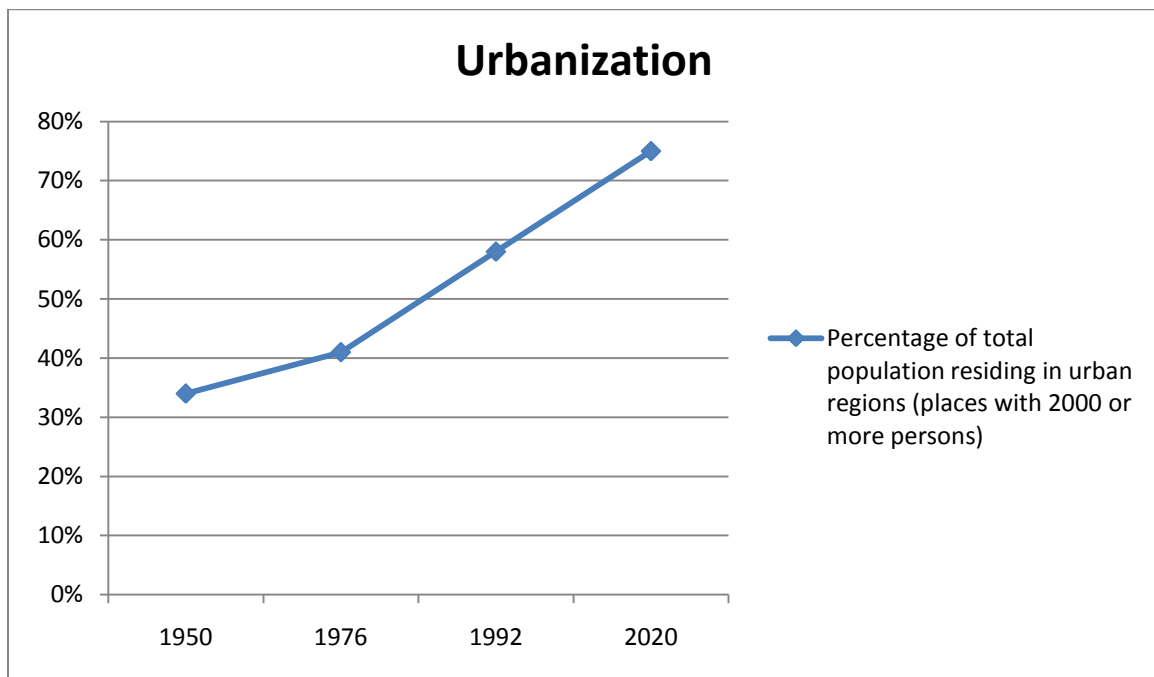
3.2.1 Acción International

The first organization that played a role in the development of microfinance in Bolivia was Acción International (Acción). Acción is non-profit organization based out of the United States (US) that is “dedicated to fighting global poverty through microfinance” (Rhyne, 2009). The highly experienced organization provides microfinance institutions around the world with technical knowledge as they begin to operate. Moreover, Acción is well connected in the international community which serves to link microfinance institutions with donor and private funding. Within Latin American, the organization targets the low-income population that has migrated to urban cities in hope of a better life. Figure 3-1 depicts the urban population growth within Bolivia from 1950-2020

¹⁵ The US Agency for International Development (USAID), Inter-American Development Bank (IDB), Freedom from Hunger and various international church organizations are just a few.

(expected). As we can see, urban areas have continuously become more heavily populated since 1950. The rate at which this urbanization occurred increased dramatically after 1976, and this growth is expected to persist in the future. With this in mind, Acción's criterion coincides well with the situation of mass migration and high unemployment that prevailed in Bolivia right before the microfinance industry began.

Figure 3-1 Urban population growth in Bolivia



Source: U.S. Department of Commerce

From the start, Acción advocated for financially viable institutions financed through the private sector. In fact, Acción was one of the first organizations to contest the general view at the onset of microfinance that services could not be provided on a commercial basis (Berger et al., 2006). The organization believed that if institutions were able to attain financial sustainability, they could draw in

private money and thus surpass the limitations involved with donor funded NGOs.¹⁶ Once it became widely acknowledged that microfinance clients were more concerned with access to money than they were with low interest rates, cost-covering rates were instituted.¹⁷ This realization encouraged the rise of financially viable institutions as costs were then able to be covered, independent of donor funds. As such, Acción's commercial approach to microfinance was unique and quite different from the model provided by the Grameen Bank.

During the mid-1980s, Acción became aware of the economic circumstances in Bolivia which made it an ideal region for microfinance services. As such, the organization decided to enter the Bolivian market. Acción introduced the concept of microfinance to a group of influential people in the country. In concert with financial support from USAID, the collective group formed PRODEM¹⁸ in 1987, one of the first and most prominent microfinance institutions in Bolivia. In 1992, Acción helped PRODEM expand their services by spearheading the transformation of the NGO into the private bank, Banco Solidario (BancoSol); in fact, BancoSol was the first commercial bank in the world that was devoted specifically to microfinance. The profitability and success that BancoSol achieved proved that commercialized institutions were worthwhile and thus instigated a trend that was widely emulated; this was particularly true in Latin America, which is one of Acción's largest networks (Rhyne, 2009; Mosley,

¹⁶ Donor funds are often unreliable and restrictive as the amount of funding dictates the maximum number of clients that can be served (Murdoch, 2000).

¹⁷ See for example Berger et al., 2006; Murdoch, 2000.

¹⁸ PRODEM stands for Fundación para la Promoción y el Desarrollo de la Microempresa or 'Foundation for the Promotion and Development of Microenterprise' in English.

2001; Marulanda and Otero, 2005). Although Bolivia was not the first country in Latin America to institute microfinance, the country's commercialized industry is widely recognized for its strength and innovation (Rhyne, 2001a). In addition to assisting PRODEM through the long and arduous transformation process, Acción worked closely with the Bolivian regulatory authorities to adjust the commercial category to accommodate microfinance institutions. Indeed, Acción's early influence in the Bolivian microfinance industry provided later entrants with a successful model of a commercialized institution and a more advanced regulatory framework.

3.2.2 Interdiziplinäre Projekt Consult (IPC)

Besides Acción, Interdiziplinäre Projekt Consult (IPC)¹⁹ was another international organization that influenced the microfinance industry in Bolivia. Similar to Acción, IPC sought to encourage the commercialization of microfinance institutions in Bolivia, taking advantage of the country's unique circumstances. IPC is a German consulting firm that focuses on institution building and management of financial intermediaries; as such, comprehensive job training of local bank employees is a major part of IPC's services. Specifically, the organization specializes in lending support to microfinance institutions and has implemented various projects worldwide. Indeed, all of the projects that IPC undertakes share a common orientation towards achieving social and developmental goals as well as long-term sustainability (IPC, 2009).

¹⁹ This translates into 'Interdisciplinary Project Consultant' in English.

In Bolivia, IPC is responsible for encouraging an innovative lending technology and aiding in the development of a new category of commercial regulation. Instead of the traditional group-lending scheme in microfinance, which was a cornerstone of the Grameen model, IPC pushed for lending on an individual basis. While this concept is common in formal banking, microfinance institutions do not typically engage in lending to individuals. However, in practice, individual lending provides microfinance clients with more freedom and flexibility as they are not dependent on or bound by the group structure. In 1992, IPC assembled a group of Bolivian diplomats, solicited donations from various organizations and formed the microfinance institution Caja Los Andes (Los Andes). Although Los Andes was the only microfinance institution that IPC was affiliated with in Bolivia, its successful use of individual lending triggered imitation throughout the country (Navajas et al., 2000). As well, Los Andes took the lead as it became the first of many microfinance institutions in Bolivia to become regulated as a fondo financiero privado (FFP).²⁰ FFP is an intermediary category of regulation that IPC helped develop (Rhyne, 2001a). Although the regulatory framework of the microfinance industry in Bolivia will be discussed in depth in the next section, it is important to note that the FFP category enables institutions to commercialize on a level that is more easily accessible. In other words, microfinance institutions that are regulated as FFPs are included in the commercial sector, but are not required to adhere to every commercial banking

²⁰ This translates into 'private financial fund' in English.

standard. This breakthrough paved the way for a commercialized microfinance sector in Bolivia and was made possible through IPC's assistance and guidance.

In sum, the economic conditions that coincided with the rise of microfinance in Bolivia were ideal for a large industry to adequately service the growing number of microentrepreneurs. Acción and IPC recognized the country's promising situation and were the driving forces behind the commercialization of a few prominent and trend-setting institutions. The next section will begin to explore the specific features of the Bolivian microfinance industry.

4: THE BOLIVIAN MODEL

The rise of microfinance in Bolivia corresponded with widespread commercialization and a stronger, more developed financial sector. Above all, regulation and institution building are two key characteristics of the Bolivian model of microfinance; they have worked together to progress the country's financial system. As financial sector development is a principle benefit of the commercialized microfinance industry in Bolivia, it is important to look at the contributing factors. This section will first examine the regulatory framework behind microfinance in Bolivia. Then, the institutional structure of several prominent Bolivian microfinance institutions will be discussed in order to fully depict the innovation and strength of the country's model.

4.1 Regulation

The most fundamental aspect of a commercial approach to microfinance is the regulation of institutions. Once a microfinance organization becomes regulated through the country's financial system, it is considered a commercial institution. In other words, the commercialization process consists of the transformation of an unregulated (i.e. non-profit) institution into a regulated institution. Since regulation, commercialization and transformation are highly intertwined, the terms will be used synonymously. Before describing the evolution of the regulatory framework in Bolivia, it is first useful to understand the reasons why organizations choose to transform into regulated institutions.

4.1.1 Why transform?

While the decision to transform or commercialize may occur for a variety of reasons, there is broad consensus on the top three motivations: 1) to access commercial sources of capital; 2) to expand outreach; and 3) to mobilize deposits.²¹ Basically, regulation enables institutions to replace donor funding with commercial sources of capital. As previously mentioned, traditional microfinance institutions that operate as NGOs are constrained by donor funds; therefore, many institutions decide to transform and become regulated in order to access more abundant sources of commercial funding. Indeed, microfinance institutions in Bolivia that are regulated under banking legislation are more attractive to private investors than unregulated NGOs (Rhyne, 2001a).

Moreover, “private sector ownership [of microfinance institutions] can improve internal control and governance since private investors have their own capital at risk” (Campion and White, 2001). Hence, commercialization and private ownership can increase the amount of capital held by a microfinance institution and enhance their operations. In addition to private sources of capital, regulated institutions can obtain public sector loans and lines of credit at low interest rates (Rhyne, 2001a). Certainly, access to public and private funding is more sustainable in the long term than unpredictable donor money. Regardless of the source, commercialization provides microfinance institutions with more opportunities to acquire a larger sum of capital. Thus, institutions are able to serve more clients and expand their outreach. Beyond that, regulated institutions

²¹ See for example Hishigsuren, 2006; Campion and White, 2001; Rhyne, 1998; Conning, 1999; Montgomery and Weiss, 2005, Rhyne, 2001a.

are permitted to offer savings accounts, which expand the services that they can provide. Therefore, commercialized institutions attract clients that wish to save and can then mobilize deposits; as a result, deposits then become an additional source of funding.

In brief, the regulation of microfinance institutions relates to more sources of cheap funding that allows for greater outreach and the expansion of services. Hence, regulation brings several positive elements to the microfinance sector and its clients. The following section will discuss how the commercialization process has developed within the microfinance industry in Bolivia.

4.1.2 Developing a regulatory framework

In Bolivia, the Superintendencia de Bancos e Instituciones Financieras (SBIF)²² is the primary government office that supervises the financial sector. The SBIF shares its power with the Central Bank of Bolivia and is responsible for the regulation of financial institutions (Navajas and Schreiner, 1998).

As previously noted, BancoSol was the first microfinance institution to be transformed into a commercial bank. However, due to the nature of microfinance, BancoSol was unable to fully comply with the regulatory framework of formal institutions; for instance, unsecured loans are in violation of commercial banking regulations (Trigo Loubière et al., 2004). In other words, formal banks are forbidden from providing loans to clients without some type of collateral in return. On the other hand, providing uncollateralized loans is a fundamental

²² This translates into 'Superintendency of Banks and Financial Institutions' in English.

characteristic of the microfinance industry. However, instead of denying BancoSol commercial status, the Superintendency was lenient with the restriction; the SBIF understood that the characteristics of the microfinance market were different from that of formal banking (Navajas and Schreiner, 1998). The flexibility displayed by the regulatory authorities demonstrates how the government has contributed to an innovative and modern microfinance industry in Bolivia.

After BancoSol commercialized, other microfinance institutions in Bolivia attempted to become regulated as well. Rather than allowing all institutions to become formal banks, an intermediate category was developed. The FFP (private financial fund) framework was specifically established for the microfinance sector in Bolivia. Again, the creation of this category represents the government's commitment to creating an advanced microfinance industry that is sensitive to the needs of institutions in Bolivia. Although the FFP requirements differ from that of formal banks, both categories are considered part of the commercial sector. The FFP framework is based on three main principles; 1) a minimum capital requirement of US\$1 million; 2) institutions must adhere to the same level of transparency as formal banks; and 3) the range of financial services is limited (Rhyne, 2001a; Navajas and Schreiner, 1998). In contrast to the first principle, the minimum capital required of commercial banks is US\$3 million; by relaxing the capital requirement, the FFP framework promotes growth of a commercial microfinance industry. Yet, formal banks are able to provide some financial services that FFPs cannot. While FFPs are able to mobilize

savings, they are prohibited from offering credit cards, checking accounts or taking part in international trade transactions. Still, the number of regulated institutions in Bolivia grew at an annual rate of nearly 20% for the period of 1986-1997 (Navajas and Schreiner, 1998). In fact, the majority of microfinance institutions in Bolivia are now financially sustainable and see commercialization as an overriding goal (Mosley, 2001). Table 4-1 depicts the regulatory category of fifteen of the largest microfinance institutions in Bolivia.²³ Undoubtedly, regulated institutions make up a large part of the microfinance industry.

Table 4-1 Regulatory categories for microfinance institutions in Bolivia

Regulated	Formal Banks	BancoSol	Los Andes		
	FFPs	PRODEM	ACCESO	AGROCAPITAL	FIE
		FONDECO	FASSIL	ECOFUTURO ²⁴	Fortaleza
Unregulated	Pro Mujer	SARTAWI	CRECER	FUNBODEM	Diaconia

Source: Author's version of table in Mosley, 2001.

In addition to developing a unique and innovative regulatory framework, the Superintendency also created several government institutions to support development of the microfinance sector. The two most notable institutions are NAFIBO (Nacional Financiera Boliviana)²⁵ and FONDESIF (Fondo de Desarrollo

²³ Please note that the table does not include cooperatives that offer microfinance services.

²⁴ ECOFUTURO is a finance company that consists of four microfinance institutions: FADES; IDEPRO; ANED; and CIDRE.

²⁵ This translates into 'Bolivian National Financier' in English.

del Sistema Financiero y Apoyo al Sector Productivo).²⁶ NAFIBO is a second-tier lender that provides credit to regulated microfinance institutions through the use of donor and government funding. NAFIBO offers loans at low interest rates and long terms-to-maturity. Since the organization is restricted to supporting only regulated institutions, many microfinance institutions in Bolivia transform in order to access this soft funding (Navajas and Schreiner, 1998). FONDESIF, on the other hand, is a financial institution that deals largely with the unregulated sector of microfinance. The organization has initiated various programs in support of providing financial services to the rural population (Rhyne, 2001a). Thus, assistance is available to the entire microfinance sector in Bolivia through these government initiatives.

In sum, the commercial orientation of microfinance institutions in Bolivia was widely shaped by government cooperation. By enhancing the regulatory framework and creating new financial institutions, the Bolivian government conveys dedication and support to the microfinance industry. Indeed, government assistance and institution building are vital components of a successful regulation process as well as financial sector development.

4.2 Institutional Structure

Beyond regulation, the second important aspect of the Bolivian microfinance model is institutional structure. While the specific philosophy of each institution varies, the underlying similarity between them consists of strong

²⁶ This translates into 'Financial System Development Fund and Productive Sector Support' in English.

performance and financial self-sufficiency.²⁷ These goals found their origins in three of the largest and most influential microfinance institutions in Bolivia: BancoSol; PRODEM; and Los Andes (Rhyne, 2001a). In fact, in 2008, the three institutions together accounted for almost 60% of the microfinance portfolio in Bolivia (MIX). Undoubtedly, many institutions learned by watching these innovators; after adopting a similar structure and methodology, institutions hoped to emulate their success (Navajas and Schreiner, 1998). It is important to analyze these leaders as they each played a role in shaping the microfinance industry in Bolivia. As such, the overall structure (e.g. services provided, lending technology) and performance (e.g. level of outreach, loan portfolio size, profitability) of these three institutions will be examined first. Afterwards, the unique qualities of a few additional microfinance institutions will be briefly considered.

4.2.1 BancoSol

By the early 1990s, the NGO PRODEM had grown quickly and was constrained by its non-profit status. In order to expand its services and access commercial sources of credit, PRODEM established BancoSol in 1992. BancoSol is the first commercial bank in the world that is dedicated exclusively to microfinance. Indeed, the transformation process was largely credited to PRODEM's alliance with Acción Internacional and several influential Bolivian businessmen (Rhyne, 2001a). With guidance from these partners, BancoSol

²⁷ The microfinance industry in Bolivia is a textbook example of the 'financial systems approach' to micro-lending. Within the broader scope of microfinance, institutions that utilize this approach are primarily focused on financial sustainability and increased outreach.

strives for growth and sustainability to enable it to meet the financial needs of as many microentrepreneurs as possible (Acción, 2009). As such, BancoSol's experience has paved the way for other institutions that wish to expand.

Currently, BancoSol operates in every major city in Bolivia, providing loans and savings services in both US dollars and Bolivianos (Koreen, 1999). Interest rates charged by the bank are slightly higher than market rates in order to ensure full cost recovery. Similar to its predecessor, BancoSol targets the urban market and employs a lending strategy known as solidarity lending. Solidarity groups are comparable to group-lending schemes that originated with Grameen Bank; essentially, both strategies inherently cope with the risks involved with providing uncollateralized loans.

Throughout the years, BancoSol has refined its lending technology to maintain efficiency and sustainability while serving its market niche. With an emphasis on communication, BancoSol focuses on highly personalized service and long-term relationships with clientele; communication is vital to any type of relationship and has proven to be a powerful incentive for repayment within the microfinance industry (Gonzalez-Vega et al., 1996a). Certainly, the high urban population density in Bolivia makes frequent contact with clients much easier to accomplish. Moreover, supplying loans to repeat customers requires fewer resources and is a more efficient way to do business. Thus, BancoSol's methodology is both resourceful and productive.

During the mid-1990s, BancoSol consistently topped the various indicators that measure bank performance. In fact, in 1998, with a 5.2% return on assets,

BancoSol was the most profitable bank in Bolivia (Fidler, 1999; Robinson, 2001). Since then, BancoSol has achieved this honor on two other occasions, which is evidence of an impressive level of financial sustainability. After a short set-back in 2001, the bank has sustained constant growth in terms of portfolio size and active borrowers.²⁸ Table 4-2 details BancoSol's growth for the period of 2002-2009. Inflation rates have also been provided to more accurately gauge growth.²⁹ Noticeably, the number of borrowers served has more than tripled throughout the seven year timeframe, and BancoSol's loan portfolio has grown to over four times the amount it had in 2002. The current levels of growth and outreach establish sustainable operations as a primary objective for BancoSol. Ultimately, BancoSol's combination of commercialization, their urban market niche and their tailored lending technology culminated in great success.

Table 4-2 Growth of BancoSol

Year	Loan Portfolio (US\$)*	Number of borrowers	Inflation Rate
2002	\$80,917,000	42,290	2.00%
2003	\$91,175,000	42,831	2.00%
2004	\$108,559,700	51,996	3.30%
2005	\$130,106,032	61,707	4.90%
2006	\$164,155,000	75,289	5.40%
2007	\$208,959,000	82,051	4.30%
2008	\$296,325,000	109,763	8.70%
2009	\$351,824,000	129,705	14.00%

*Please note that all dollars amounts in this study will be in US\$ unless otherwise specified.

Source: Acción, 2009 and CIA World Factbook, 2010.

²⁸ Loan portfolio size and the number of borrowers are two common indicators of growth and sustainability within the microfinance sector.

²⁹ Please note that Bolivia's inflation rates are comparable to other countries in the region. Although inflation increased in 2009, the rate is expected to decrease to the 4-5% range in 2010 (CIA World Factbook, 2010).

4.2.2 PRODEM

When BancoSol was established, the institution assumed PRODEM's loan portfolio and client base; yet, instead of completely eliminating PRODEM, the partners behind the two institutions decided to maintain the organization. Thus, PRODEM continued to exist, but was virtually a new NGO. By 2000, PRODEM had achieved financial sustainability and converted into a FFP.

Like BancoSol, PRODEM offers savings services and utilizes solidarity groups in its lending technology. Though, once BancoSol was instituted, PRODEM decided to shift its focus to the underserved rural population.³⁰ However, providing financial services to rural clients is more difficult than urban lending. For example, in Bolivia, rural areas are more sparsely populated which increases transactions costs (Armendáriz and Szafarz, 2009; Navajas et al., 2000). Repayment problems arise for both the client and the lender when distance is an issue; loan servicing is more difficult for clients that reside in remote areas. In addition, rural lenders must manage the risks associated with borrowers who specialize in agriculture. The seasonal nature of agricultural income makes even medium-term lending difficult; poor weather conditions can affect the crops in an entire area which creates an added risk for lenders to protect against (Rhyne, 2001a; Gonzalez-Vega et al., 1996b). Therefore, compared with urban lenders, rural institutions must deal with a variety of additional factors. This is likely a reason why many microfinance institutions prefer to service urban clients (Armendáriz and Szafarz, 2009).

³⁰ The change in target market also prevented the highly connected PRODEM and BancoSol from competing for the same clients (Navajas et al., 2000).

PRODEM, on the other hand, confronted the rural challenges and engineered a lending technology that was suited to rural needs. As agriculture is the predominant business in rural Bolivia, PRODEM first spent time learning the intricacies of the industry. Then, the institution tailored loan terms to accommodate the specific circumstances of rural clients; for instance, PRODEM offers differential quotas to account for seasonality (Rhyne, 2001a). In other words, the size of loan payment decreases for agricultural clients during the off season. Less frequent payment schedules is another effort employed by PRODEM to minimize transaction costs (Gonzalez-Vega et al., 1996b). Although the changes were subtle, the rural lending technology that PRODEM initiated was a success. PRODEM was the first institution in Bolivia to achieve profitability and large scale outreach while lending to rural clients (Rhyne, 2001a). Evidently, PRODEM overcame the challenges presented by rural lending. Moreover, their extensive research and small modifications to the existing lending technology can be easily transferred to other microfinance institutions in Bolivia.

With almost 100,000 borrowers and a loan portfolio of US\$240 million, PRODEM has reached significant scale (MIX, 2008). The institution has created an innovative technology that has succeeded in earning profits while providing financial services to the underserved rural population. This achievement has opened the door for other institutions to service the rural market.

4.2.3 Los Andes

Los Andes is the final institution in Bolivia whose significant scale and innovation has shaped the microfinance industry. Shortly after BancoSol

achieved commercial bank status, Los Andes petitioned for similar treatment. Although the regulatory authorities failed to accommodate Los Andes' exact request, they agreed to make a few modifications to the commercial stipulations which culminated in the creation of the FFP category. Los Andes and its team of partners helped design the commercial classification and inaugurated the institution as the first FFP in 1995. Indeed, this innovation has been emulated by many other financially viable institutions in Bolivia that have sought to expand operations. However, a decade later, FFP status was inadequate to meet Los Andes' growth aspirations; consequently, in 2004, Los Andes transformed into the second commercial microfinance bank in Bolivia (Berger et al., 2006).³¹ Due to the example provided by BancoSol's previous transition, the transformation process was much easier for Los Andes. In fact, in 2007, Los Andes outperformed the bank with a loan portfolio of about US\$270 million as compared to BancoSol's US\$200 million portfolio (Dacheva, 2009). That same year, Los Andes served over 12,000 more borrowers than BancoSol (MIX, 2008). Since Los Andes and BancoSol both target the urban population, the two institutions thus compete for the same market. These results suggest that the innovations of early institutions have developed the microfinance industry in Bolivia and eased the path for those that followed. As a result of the imagination and risk-taking of the early innovators, superior institutions have since evolved.

In addition, Los Andes is credited as the first microfinance institution in Bolivia to offer individual loans (Rhyne, 2001a). Providing individual loans is not a

³¹ The full name of the commercial bank is now Banco Los Andes ProCredit; however, the institution will continue to be referred to as Los Andes for simplicity.

typical lending technology used by microfinance institutions; group lending schemes are more attractive when lending to the poor due to the built-in incentive for loan repayment. However, Los Andes has found a way to achieve the same results while providing individual loans by asking their clients to pledge some type of collateral. Los Andes has discovered that “incentives to repay emerge from the credible threat of seizing assets”, even if the collateral is merely a sofa (Navajas et al., 2003). The technology has worked well for Los Andes, and many other microfinance institutions in Bolivia now employ individual lending (Navajas et al., 2000).

4.2.4 Additional institutions

Beyond the three aforementioned institutions, there are a few additional organizations worth mentioning. For instance, el Centro de Fomento a Iniciativas Económicas (FIE)³² is a FFP microfinance institution that has flourished without a major source of technical assistance (Navajas et al., 2000). BancoSol, PRODEM and Los Andes were each partnered with international organizations that influenced and encouraged their success. Despite the lack of support and guidance, FIE has grown into the largest FFP in Bolivia, which can be seen in Table 4-3. Similar to Los Andes, FIE targets the urban market, provides individual loans and has transformed into a FFP institution. In a sense, Los Andes’ previous experience has provided FIE with the assistance it needed by carving out a path that the institution could then follow.

³² This translates into ‘The Center for Economic Development Initiatives’ in English.

Table 4-3 Loan data for select microfinance institutions (2008)

Type*	Name	Gross loan portfolio	Number of borrowers
Bank	Los Andes	\$342,933,151	111,022
Bank	BancoSol	\$294,214,815	109,763
FFP	FIE	\$244,433,565	103,584
FFP	PRODEM	\$239,078,783	98,207
NGO	Crecer	\$37,143,879	100,387
NGO	Pro Mujer	\$27,812,930	87,626

*Please note that 'Bank' denotes a commercial (microfinance) bank, 'FFP' indicates a regulated private financial fund and 'NGO' status is an unregulated non-profit institution. Source: MIX, 2008

Crecer³³ and Pro Mujer³⁴ are the final two institutions to consider. Highly dedicated to social goals, both organizations target the poorest of the poor, similar to the original Grameen model. Beyond providing financial services, Pro Mujer specializes in women's education and empowerment training. On the other hand, Crecer is strongly oriented towards achieving basic health and nutrition for the Bolivian people. Because of Pro Mujer and Crecer's devotion to social objectives, neither institution has any intention of becoming regulated in any capacity (i.e. commercial bank, FFP); they feel that maintaining their NGO status is the only way to continue servicing the poorest population (Rhyne, 2001a). For example, non-profit institutions are able to offer below market interest rates as cost recovery and profit-making objectives are secondary to social goals. Low interest rates allow clients to keep more of their money, and thus allow the poor to utilize their funds more productively. Since most of the microfinance institutions in Bolivia are financially driven, social initiatives are not a common occurrence. Therefore, Pro Mujer and Crecer's social approach to microfinance

³³ This translates into 'to grow' in English.

³⁴ This translates into 'Programmes for Women' in English.

is unique within Bolivia. Although Table 3-3 shows that Pro Mujer and Crecer's loan portfolios are significantly less than their regulated counterparts, the number of borrowers that each institution serves is competitive. Despite their disinterest in commercialization, the two organizations contribute to the diverse institutional structure of the microfinance industry in Bolivia.

In brief, the Bolivian model of microfinance is composed of an advanced regulatory framework that has both encouraged and helped develop a commercialized industry. Moreover, the government supported apex institutions and new categories of regulation have enhanced Bolivia's financial system. Furthermore, innovative technologies, strong institutional structures and high performance have provided the leading microfinance institutions in Bolivia with the profitability necessary for sustainable operations. As many institutions follow their lead, the microfinance industry continues to grow and the financial sector in Bolivia becomes more highly developed. The following section will discuss some of the effects of the commercialized microfinance industry in Bolivia.

5: IMPACTS OF COMMERCIALIZATION

Since it has been firmly established that the microfinance industry in Bolivia is widely regulated, it is now useful to further examine how commercialization has impacted clients, institutions and microfinance in general. As such, this section will look at the effects of competition, financial sector transformation, and discuss the possibility of mission drift within the microfinance industry in Bolivia.

5.1 Competition

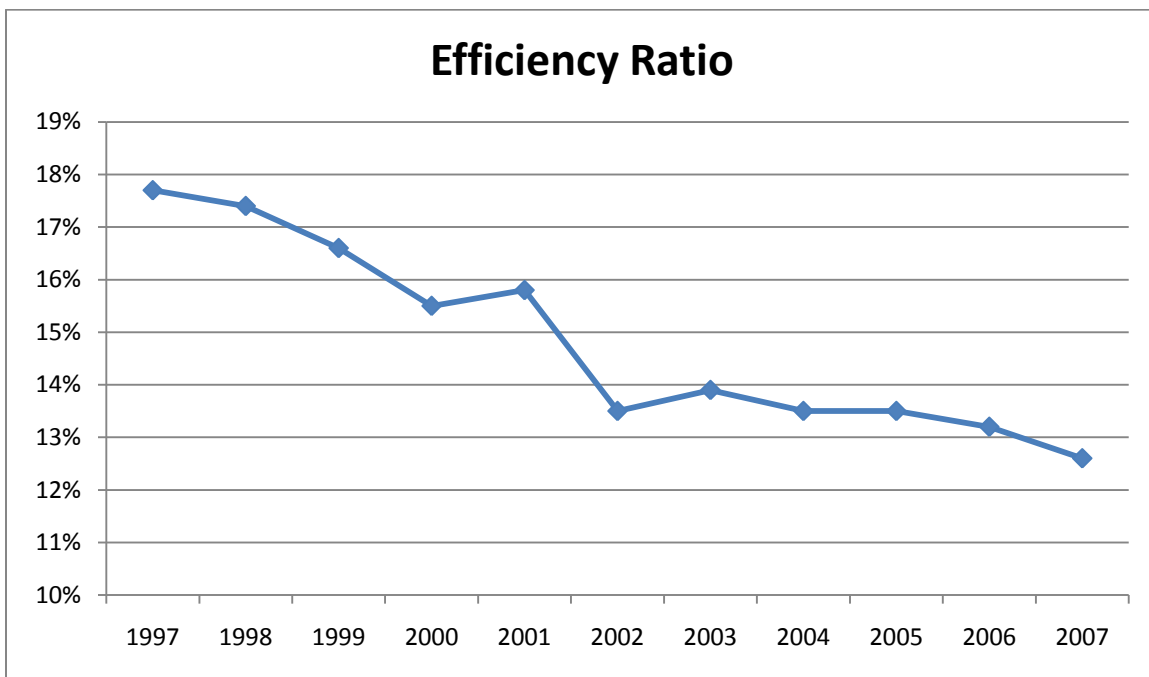
Competition among microfinance institutions arose early in Bolivia as the barriers to entry were low due to a supportive government and regulatory framework (Berger et al., 2006). As the number of commercial institutions increased, they began to compete for clients and became more responsive to their needs. In order to attract customers, institutions in Bolivia have increased efficiency, lowered costs and expanded services. However, competition within the microfinance industry has also led to urban market saturation and a period of over-indebtedness. Each of the aforementioned factors will be briefly considered.

5.1.1 Increased efficiency

The primary indicator used to measure efficiency for microfinance institutions is the ratio of administrative costs to average gross loans. As such, Figure 5-1 depicts the efficiency ratio for regulated institutions in Bolivia over a

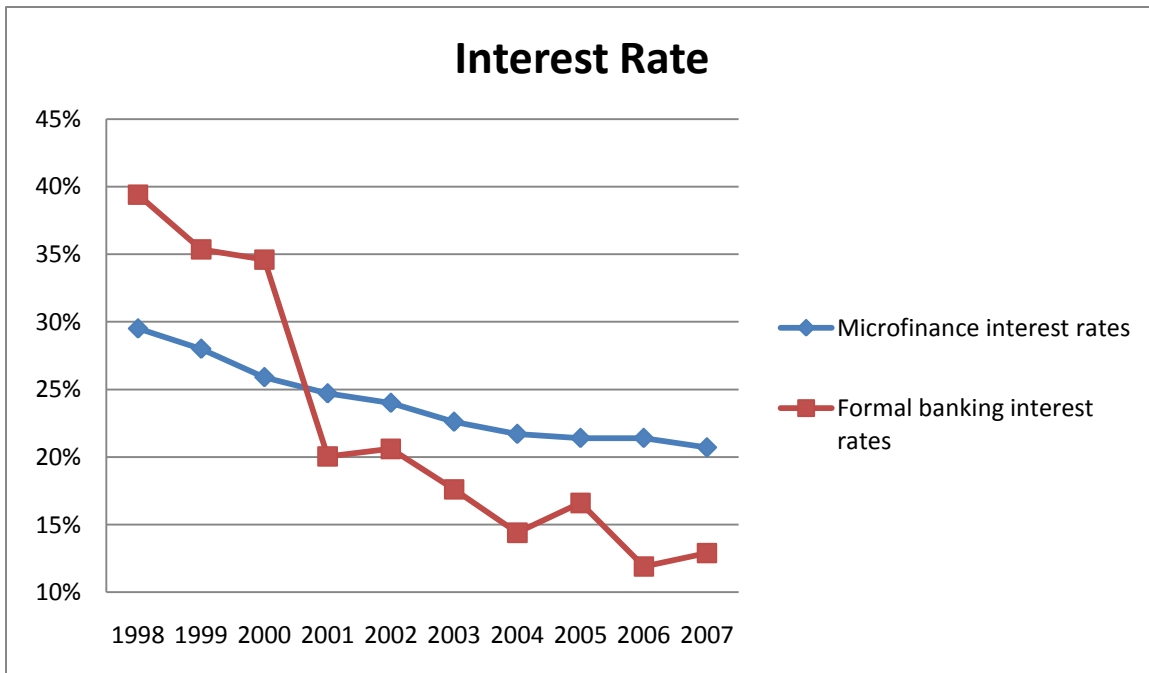
10-year period. The downward sloping line signifies a decrease in administrative costs as average gross loans are increasing. In other words, the amount of money required to service a loan is decreasing, which is indicative of more efficient operations. Beyond that, the rate of arrears for regulated institutions has decreased from 12.13% in 2001 to 1.42% in 2007 (ASOFIN, 2007). With fewer loans in default, institutions are able to concentrate their energy on more constructive aspects of microfinance and are thus better utilizing their time. Moreover, improved efficiency and the reduction of operational costs have resulted in lower costs for clients, primarily with regards to interest rates. In fact, “interest rates on Bolivian microloans are among the lowest in Latin America” (Trigo Loubière et al., 2004). Figure 5-2 shows the average interest rate charged by regulated institutions in Bolivia from 1998-2007. This figure also illustrates the interest rates charged within the formal financial sector in Bolivia; though the formal rates are currently lower, they are more erratic than microfinance interest rates which have declined at a steady pace. A consistent decrease in interest rates provides a more effective and reliable environment for low-income microfinance clients as they are better able to anticipate costs. Above all, competition has provoked a more efficient microfinance sector that has reduced expenses for both institution and client.

Figure 5-1 Administrative costs / Average gross loans (%)



Source: ASOFIN, 2007

Figure 5-2 Average interest rate of loans (%)



Source: ASOFIN, 2007 and IMF, 2008

5.1.2 New services

Beyond lowering costs, offering new products and services is another strategy for microfinance institutions as they compete for clients. Historically, competition within the microfinance field has failed to increase services (CGAP, 2001; Sengupta and Aubuchon, 2008); yet, in Bolivia, there are a few new services worth mentioning. For example, some of the larger institutions now offer life insurance, remittance services, debit cards and automated teller machines (ATMs) (Schicks, 2007). The latter two services improve efficiency as they provide clients with easier access to funds. Although expensive to initiate, technological advancements will certainly improve the quality of financial services in the future. An additional service that has expanded in Bolivia due to competitive forces is the provision of savings programs. These programs are important for microfinance clients as they provide a secure location for the low-income population to keep their excess money. Meanwhile, clients are building up assets to use as collateral and earning positive returns on their money (Morduch, 2000). Thus, savings programs encourage responsible money management and income growth. Furthermore, savings mobilization is a sustainable source of funding for microfinance institutions; this promotes a deeper level of financial sustainability as institutions cease to necessitate concessionary or government loans. Even though savings services are costly at first, the initial expense is paid off with the future benefits enjoyed by both institutions and clients (Miller, 2003).

Microfinance institutions in Bolivia have acknowledged savings as a vital service to the poor and cheap capital to fuel growth; in fact, deposits have increased from about US\$100 million in 1999 to almost US\$800 million in 2008 (ASOFIN, 2008). Clearly, microfinance institutions and clients are taking advantage of this mutually beneficial service. Although the Bolivian industry has not experienced a vast increase of new services, the few they offer promote a sustainable and efficient sector.

5.1.3 Urban market saturation

Inevitably, commercialization and competition has led to an influx of new microfinance institutions, each fighting for their share of the market by offering lower costs and providing new services. However, the size of the market in Bolivia has not grown with the same stamina. In 1999, a report issued by CGAP³⁵ (2001) indicated that the microenterprise market in Bolivia had been severely penetrated. In other words, the number of loans provided throughout the year largely exceeded the estimated market size. Since many microfinance institutions in Bolivia target the urban population, this market has been heavily saturated (Trigo Loubière et al., 2004). Conversely, rural areas contain the majority of unmet demand for microfinance services (Navajas and Schreiner, 1998). Although providing financial services to rural areas is hindered by high transaction costs and poorer clients,³⁶ rural demand has the potential to attract microfinance institutions. As the urban market becomes saturated, microfinance

³⁵ CGAP stands for 'The Consultative Group to Assist the Poorest'.

³⁶ In 1992, about half of the urban population in Bolivia was living below the poverty line whereas almost all rural households were poor; moreover, 74% of the rural poor were in the poorest class (Navajas et al., 2000). Thus, rural poverty in Bolivia is both broad and deep.

sector growth will slow until a less penetrated market is found. By extending services to rural areas, microfinance institutions in Bolivia will better serve the poorest population and be able to continue the sector's growth. Perhaps, some of the institutions in Bolivia could learn from and replicate PRODEM's successful and profitable model of rural lending.

5.1.4 Over-indebtedness

Despite the narrowing market for microcredit in Bolivia, profitable institutions continue to entice new entrants into the sector. For example, in the late 1990s, a large and established Chilean consumer credit company (Acceso) decided to expand its operations and move into the Bolivian market. Similar to microfinance, consumer lending consists of providing small-scale loans; however, consumer lenders focus on serving clients that earn a salary. With strong financial backing and an established methodology, Acceso and its consumer lending technology spread quickly throughout Bolivia. Within three years, the company had reached \$90,000 in total outstanding loans, "a scale that BancoSol had not achieved in the twelve years since its origin as PRODEM" (Rhyne, 2001a). Due to Acceso's success, several domestic consumer lending institutions were established in Bolivia, closely following the company's methodology.

Thereafter, upon recognition that salaried workers are a minority in Bolivia, Acceso and various other consumer lenders decided to move into the highly profitable microenterprise sector, and directly compete with microfinance institutions (Rhyne, 2001b). In order to contend, the consumer lenders began

offering low-income microentrepreneurs large loans at low rates, yet neglected to adopt a methodology fit for the informal market. Indeed, poor and self-employed individuals require a different lending technology than salaried employees who are paid on a consistent basis. Despite this, Acceso's methodology went unchanged and consumer lenders continued to provide loans. As the two industries struggled for market share, clients took advantage of large and cheap credit and began borrowing from multiple lenders. Then, in 1999, a financial crisis hit Latin America and "thousands of borrowers were revealed to have borrowed more than they could handle" (Trigo Loubière et al., 2004). Default rates drastically increased among consumer and microlenders alike (Rhyne, 2001b). Once the Superintendency recognized the magnitude of the problem, restrictions were imposed on the size of loans that consumer lenders could offer. Shortly after, consumer lending vanished, leaving behind a weakened microfinance industry. BancoSol and PRODEM suffered the greatest losses as they were the two largest institutions in Bolivia, servicing nearly half of the microfinance market at the time (MIX, 2008). In fact, between 1999 and 2000, BancoSol lost 25% of their clients and PRODEM lost 45% (Rhyne, 2001b). Despite this set-back, both institutions were able to fully recuperate their market share by 2005 (MIX, 2008).

In an effort to prevent future over-indebtedness, the Superintendency has enhanced the Bolivian credit bureau. Extensive information is now required of even small-scale clients to avoid multiple loans and over-borrowing (Trigo Loubière et al., 2004). While the microfinance industry was not solely responsible for the period of over-indebtedness, the competitive and profitable sector did

encourage the reckless entry of consumer lenders. In the end, the microfinance industry prevailed as consumer lenders failed to fully understand the risks involved with lending to low-income microentrepreneurs.

Although competition has not resulted in a vast increase of social services due to the profit orientation of microfinance institutions in Bolivia, clients have gained from lower costs and more opportunities. These benefits translate into greater efficiency for institutions and the microfinance sector as a whole. Moreover, even market saturation and the lending crisis that resulted from a highly competitive microfinance industry had some positive outcomes; rural market penetration and more responsible lending procedures promote valuable sector growth and development.

5.2 Financial Sector Transformation

Beyond instigating a competitive industry, the commercialization of microfinance institutions in Bolivia has also affected the financial sector in various ways. Certainly, the advanced regulatory framework that was created for microfinance has strengthened and developed financial sector authority and institutions. However, the commercialized microfinance industry in Bolivia has also transformed the structure of the country's financial sector. González and Villafani (2006) argue that this transformation has had both aggregate and substitution effects. With regard to aggregate effects, microfinance in Bolivia has introduced financial services to a growing population of low-income clients that would otherwise be excluded from traditional banking. The microfinance industry thus expands the potential market for financial services. In fact, the microfinance

sector in Bolivia has been growing faster than traditional banks because it has found this untapped market that it can effectively serve. Table 5-1 displays the total loan portfolio values for both traditional and microfinance banks from 2001-2009. Traditional banks offer a smaller number of larger loans and thus maintain a more sizable loan portfolio than microfinance institutions (Berger et al., 2006). Regardless, the table indicates that loan values for traditional banking fluctuated throughout the period, increasing about 34% overall. In contrast, the microfinance industry's total loan portfolio rose steadily, rising by 749% throughout the same timeframe.³⁷ As a whole, the total loan portfolio of the banking sector in Bolivia grew by 85%. Therefore, the entry of microfinance institutions into the Bolivian market has contributed to financial sector growth and a more diversified banking system.

Table 5-1 Loan portfolio values in millions

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009
Traditional Banking Sector	\$3015	\$2667	\$2552	\$2420	\$2595	\$2767	\$3204	\$3734	\$4131
Microfinance Sector*	\$218	\$258	\$328	\$491	\$629	\$881	\$1160	\$1556	\$1850

*The numbers indicated are for microfinance institutions that report to MIX market.

Source: MIX, 2010 and ASOBAN, 2010

³⁷ This percentage is an estimate as the available data only includes reporting institutions.

Furthermore, the substitution effect relates to how microfinance has replaced informal funding with formal services (González and Villafani, 2006). This shift provides low-income clients with an alternative to the usurious interest rates charged by informal moneylenders, and thus allows them to use their money in a more productive way. Indeed, microfinance has enhanced the composition of the financial sector in Bolivia, and the commercialized industry has discovered a profitable way to serve poor clients in a formal manner. This is a great feat as traditional financial institutions have typically found this population too risky. More recently, formal banks have noticed the success and profitability of microfinance institutions and have begun to explore this new market. As traditional banks struggle to survive in the highly integrated and competitive financial industry in Bolivia, a few have moved down-market to take advantage of the plethora of low-income clients. The most notable bank in Bolivia to downscale their operations is Banco Económico. Although a couple of other banks have entered the microfinance market throughout the years, Banco Económico has devoted the most resources towards establishing the segment and is thus a useful bank to examine in more detail (Rhyne, 2001a).

In 1997, Banco Económico opened a microfinance division named Presto that focused on providing quality and efficient services to the poor population. During the first year, Presto had a 97% repayment rate and internal projections suggested that the division would soon generate high profits (Poyo and Young, 1999). Less than three years later, however, Presto was completely eliminated as the division was unable to endure the credit crisis that struck the microfinance

industry in Bolivia (Rhyne, 2001b). Yet, even in the absence of a financial crisis, formal banks face several obstacles upon entering the microfinance sector; imperfect information, elevated transaction costs and high risk are just a few barriers to entry (Navajas and Schreiner, 1998; Robinson, 2001; Baydas et al., 1997). Microfinance institutions have spent extensive time and resources to learn how to overcome these issues. Apparently, it is either more difficult for formal banks to master a lending technology suited to low-income clients, or simply unappealing to do so as few have attempted to enter the market in Bolivia and none have been successful (Rhyne, 2001b).

Consequently, even though formal banks have been slow to integrate into the microfinance market as this time, the industry could benefit from their entry. For example, the established infrastructure, internal controls and widespread branch networks would add value to the microfinance sector (Navajas and Schreiner, 1998; Baydas et al., 1997); utilizing existing structures and systems would provide an inexpensive way to produce growth and service more clients. Moreover, formal banks offer larger loans than microfinance institutions, for longer terms-to-maturity (Berger et al., 2006). Options such as these are beneficial for less poor clients who wish to graduate from the smaller, short-term loans supplied through microcredit. Though the obstacles seem to outweigh the benefits at this time, the successful downscaling of formal banks could help escalate the microfinance sector in Bolivia to the next level.

Ultimately, the commercialization of microfinance has augmented the number and type of clients served in the formal banking sector; as such, the

financial industry in Bolivia has transformed into a larger more sustainable system.

5.3 Mission Drift

The final impact of a commercial microfinance industry is the possibility of mission drift. Essentially, as microfinance institutions commercialize, there is concern that the focus may shift away from the original poverty reduction goal of microfinance, culminating in mission drift. The general idea is that as institutions expand and scale-up their operations, their efforts to reach more clients by securing financial sustainability may result in providing “larger loans to less poor clients and [employing] stricter loan screening procedures” (Opportunity International, 2007). Accordingly, average loan size is a commonly used indicator of mission drift. Also, commercialized institutions might reach out to better-off and less risky customers to prevent loan delinquencies (Opportunity International, 2007). As such, the poorer population and poverty alleviation objective are neglected in the anticipation of greater profits.

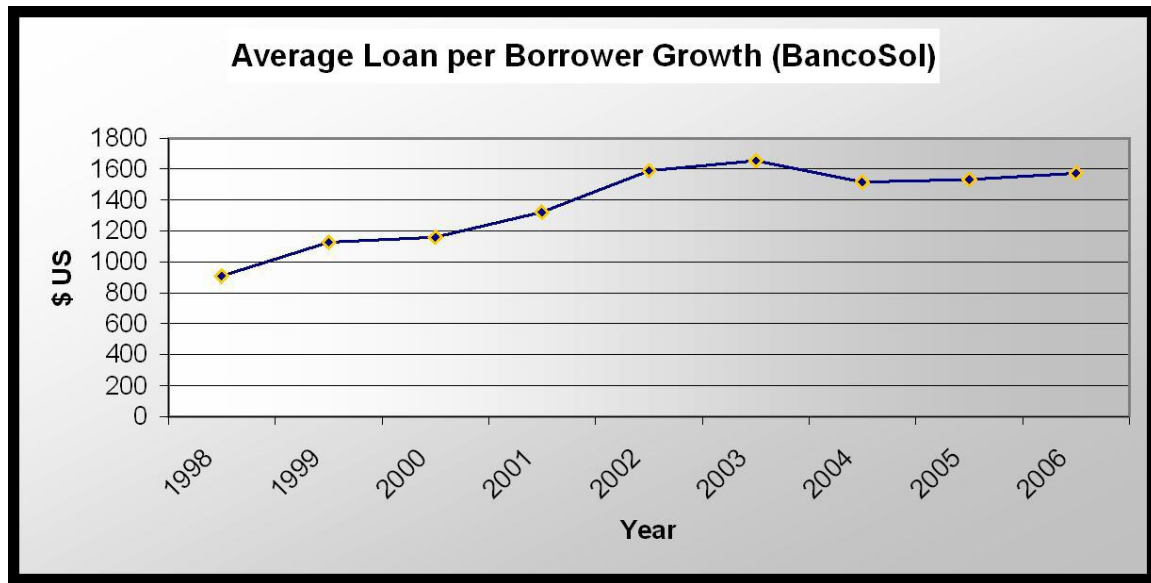
As commercialization or scaling-up is a prominent characteristic of the microfinance industry in Bolivia, the possibility of mission drift has become an increasing concern. There is a growing debate surrounding the existence of mission drift among microfinance institutions in the country. One institution that has received much attention pertaining to this issue is the highly profitable BancoSol.³⁸ BancoSol targets the urban market which is typically the upper segment of the poor population. While the institution “still claims to be dedicated

³⁸ See for example CGAP, 2001; Barzelay, 2008; Dacheva, 2009; Rhyne, 2001b.

to the poor, 20 percent of their clients are in fact not poor and the remaining 80 percent are not exclusively under the poverty line” (Barzelay, 2008). In contrast, Grameen Bank and microfinance in general was premised on servicing the poorest of the poor. By choosing to serve less poor clients, some believe that the commercial nature of microfinance in Bolivia heavily mirrors traditional banking, and will one day exclude the poor population that microfinance was intended to serve.³⁹ This is particularly concerning since BancoSol is one of the strongest organizations in Bolivia, whose strategies are followed by many other institutions. Despite these apprehensions, however, BancoSol continues to reach low-income clients that would otherwise not have access to financial services. As previously noted, average loan size is often used as a proxy for poverty to indicate mission drift. Figure 5-3 displays the average loan size for BancoSol clients from 1998-2006. The figure indicates that average loan size remained relatively constant after the financial crisis in 2001. As such, the concern surrounding the intentions and goals of BancoSol is unsubstantiated. Although sustainability and profitability are objectives for the majority of institutions in Bolivia, the poor population continues to be served.

³⁹ See for example Barzelay, 2008; Dacheva, 2009.

Figure 5-3 Average loan size - BancoSol



Source: Dacheva, 2009

Moreover, it is also important to determine whether poverty alleviation is in fact the mission of all microfinance institutions. Certainly, this assumption is based on the original principles upon which microfinance began. However, as the microfinance industry has evolved over the past three decades, a plethora of different types of institutions have been established, and an all-encompassing single mission no longer seems practical. For instance, microfinance in Bolivia was largely implemented to generate employment for the urban informal sector and to promote small enterprise development (CGAP, 2001; Montgomery and Weiss, 2005). While poverty alleviation is likely a goal of institutions in Bolivia, the country's microfinance industry was not premised on serving the poorest population. Instead, the commercialized sector is oriented towards serving urban clients, profit-making and sustainability. Indeed, these objectives have resulted in an industry with greater outreach and more services. Ultimately, microfinance

institutions must be sustainable to continue serving the poor; the achievement of this goal merits support regardless of the level of poverty the institutions reach.

In sum, the commercialization of microfinance institutions in Bolivia has improved efficiency and expanded outreach, which has resulted in higher profits. Accordingly, clients are presented with more options and lower costs. As a whole, the microfinance industry has experienced rapid growth and has become more integrated with the formal financial system. This union lends to greater efficiency and more widespread services within the financial sector.

6: CONCLUSION

Indeed, microfinance in Bolivia is a multifaceted and dynamic industry. The country's unique economic circumstances in the mid-1980s created a situation that was ripe for a commercialized microfinance industry. With the help and support from international organizations, local businessmen and the government, the microfinance sector in Bolivia has evolved into a highly profitable and commercialized industry.

As the sector began to flourish, a few microfinance institutions proved to lead the way with regard to innovation and profitability. The path these institutions paved eased the road for other institutions that followed. Their strong institutional structure and tailored lending technologies created a wave of emulation that resulted in a highly competitive commercial industry. Consequently, competition provoked more efficient operations which lent to lower costs and more options for clients; in addition, outreach expanded and profits increased. Therefore, commercialization has produced effective and successful financial institutions that positively contribute to the banking system in Bolivia. Moreover, competitive forces have helped to integrate the low-income population into a more formal financial sector. Thus, while the microfinance industry in Bolivia promotes development of the country's financial system, the informal sector is both included and empowered.

Additionally, the regulatory framework of microfinance institutions in Bolivia has played an important role in advancing the financial sector. Indeed, regulation is a major component of a commercialized industry. However, the nature of microfinance is vastly different than that of traditional banking; upon this realization, the Bolivian government worked with the institutions and international organizations to develop regulatory categories suited to the needs of the microfinance industry. Certainly, government support and assistance simplified the commercialization process for microfinance institutions. By improving and strengthening banking regulations, commercialization has integrated microfinance institutions into the formal banking sector and expanded the country's financial system.

Overall, the commercial microfinance industry in Bolivia has resulted in more a diversified and financially stable banking system. Clients, institutions and the country's financial sector each stand to benefit from more sustainable operations. Moreover, Bolivia's experience provides valuable lessons and insights for the microfinance institutions of countries in the region that have a less developed commercial sector.

Perhaps the Bolivian case study illustrates that, in the beginning, commercial microfinance industries focus on financial sector development instead of poverty alleviation; especially when one considers that the Bolivian industry continues to expand in a virtually saturated urban market, and that this should have the effect of placing rural lending at the forefront of future microfinance institutions. In turn, this will likely focus efforts on poverty reduction.

At this point, the commercial microfinance industry in Bolivia would encompass a fully integrated informal sector and perhaps be able to improve inequality in the future.

Nevertheless, it remains to be seen whether microfinance institutions will be able to develop innovative lending technologies to service the rural population on a large scale basis while sustaining profits. Moreover, it is unclear whether the microfinance industry will ever amount to a sector that is large enough to create significant economic changes in Bolivia. These questions are of fundamental importance to the future of microfinance in Bolivia, and elsewhere in the world. While it is clear that there is no best practice, Bolivian institutions have succeeded in creating a profitable commercial industry that is unique to the particular needs of that country. Although poverty alleviation and economic development are not at the forefront of the Bolivian microfinance industry, the country's model does address financial system development and informal sector integration; this focus should be given merit in microfinance for the many achievements that have been discussed throughout this case study. Furthermore, the benefits of a commercialized model of microfinance will be even more apparent if the Bolivian industry does, in fact, achieve poverty reduction of the rural class in the future.

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