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## Banco Solidario S.A.: The Recovery Strategy, 2000–2004

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## Banco Solidario S.A.: The recovery strategy, 2000–2004☆

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## ABSTRACT

Five years passed since, in April, 2000, Kurt Koenigsfest took over as the Chief Executive Officer at Banco Solidario S.A. (BancoSol), in La Paz, Bolivia. BancoSol had become the top Latin American bank specializing in providing microbusiness services. Since its beginning in 1992, BancoSol achieved excellent results and became an international reference in the microcredit area. In mid-2000, external and internal factors caused its performance to deteriorate. Kurt and his management team set and implemented a strategy that led the bank to be rated as the best financial institution in the Bolivian financial system in 2004. The time had come to plan for the future; the management team has to establish BancoSol's primary lines of action for the next three years.

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## 1. Bolivia

## 1.1. The economic situation

In 1985, Bolivia underwent one of the worst economic crises in its history. The budget deficit produced severe hyperinflation, reaching levels of up to 11,700% in 1985. Between 1982 and 1986, economic activity decreased at an average rate of  $-3.4\%$ , and the public sector deficit was close to 25% of the GDP.

In August 1985, the government established a monetary stabilization program. A series of reforms was applied, which included reducing the size of the primary state companies and the state itself, renegotiating or rescheduling external debt, establishing unique uniform tariffs, simplifying the taxation system, and stabilizing the exchange rate with full price liberalization. By 1988, inflation had dropped to 20%. From 1993 to 1998, economic growth reached an average annual rate of 4.7%, due in large part to a second wave of reforms that included changes in the pension system and the market capitalization of the most important public companies. Direct foreign investment

doubled during this period, and the fiscal deficit reached 4.7% of the GDP.

In 1998, the Bolivian economy entered into a deceleration period as a consequence of various external and internal shocks. The international financial crisis in Southeast Asia in 1997 and in Brazil 1998 produced a drop in export product prices and deterioration in the exchange terms, affecting national production. Several weather problems considerably affected the agricultural sector. The hydrocarbon sector experienced a contraction associated with the end of the gas export contract with Argentina and deferral of gas sales to Brazil. Internally, in 1998, the Dignity Plan was applied to eradicate the surplus coca crops in the country. This plan exposed the economy's dependence on producing and marketing coca. A new customs law went into effect in 1999, which reduced the contraband that was entering the country from Chile.

In 2003 and 2004, the international context was favorable for Bolivia due to better prices and lower interest rates in international markets. However, social and political conflicts interrupted the normal economic activity rate and generated a climate of uncertainty that affected how the financial system functioned and the trust of external investors. During these years, there was a considerable increase in hydrocarbon sector exports, which primarily resulted from an increase in the volume of natural gas exported to Brazil and a renewal of natural gas exports to Argentina.

## 1.2. The political situation

After two decades of military dictatorships, democratic governments began to lead the country in 1992. Since 2003, social

☆ The case was written with the financial support from the Microfinance Management Institution as part of its project "MBA programs in microfinance" as a way of contributing to analyzing Latin American administrative and financial issues in the microfinance sector. Appendix 1 shows a high reliability analysis of the case. Appendix 2 shows a teaching note for class discussion; Luis Noel Alfaro (INCAE Business School, Campus Francisco de Sola, Nicaragua, Luis.Alfaro@incae.edu) is the first author of the teaching note.

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movements and governance crises have characterized these governments. In February 2003, President Gonzalo Sanchez de Lozada, supported by a political coalition that gave him a majority in Congress and the state security forces (policy and military), created a new wage tax to reduce the fiscal deficit that in 2002 had reached 9% of the GDP. Days later, the tax was canceled because of the public's irate rejection.

The natural gas export project and the dispute over approving the surpluses generated by this resource caused a new political crisis. In August 2003, the government decided to go ahead with a natural gas export project, retaining the existing legislation that only imposed 18% in taxes and royalties on operating companies. In 2003, an escalation in protests against this measure spiraled into a strike impelled by the neighborhood organizations in the city of El Alto. The strike paralyzed activities in the city and blocked access to the seat of government for the rest of the country. The government began using the military and the police to try to put an end to the conflict. The confrontations caused approximately 80 deaths, and 400 people were wounded. The president was forced to step down, and Vice President Carlos Mesa assumed the country's presidency.

In a national vote held on July 18, 2004, citizens backed the new government's policy in relation to natural gas exploitation. In January 2005, major protests ignited again against a governmental decree that called for an increase in fuel prices. The protests became especially serious in Santa Cruz, where the so-called "Pro Santa Cruz Civic Movement", made up of business people, union sectors, and mayors' offices, announced the immediate election of an assembly to define departmental self-governance. The president of this committee proclaimed autonomy and announced that he would call for elections for a new governor and a referendum that would make Santa Cruz an autonomous state.

On March 7, 2004, faced with the continuing crisis, Mesa extended an offer to Congress to step down. His resignation was not accepted, and his presidential project was approved to achieve a major social pact between the main forces and put an end to the imbalance throughout the country by calling on a constituent assembly to modify the state's political constitution and to strengthen regional autonomy. In May 2004, the Hydrocarbon Law was declared, establishing an increase in the taxes and royalties paid by foreign oil companies. The demonstrations returned in force at the end of the month, as the new law did not satisfy indigenous and mining organizations. Faced with these obstacles, Mesa resigned and was replaced on June 9, 2004, by Eduardo Rodriguez, the president of the Supreme Court of Justice. On December 4, 2005, Bolivia would enter a new electoral process in which eight candidates aspired for the presidency.

### 1.3. The social situation

By 2004, Bolivia was one of the most unequal countries in terms of the distribution of wealth. The poorest 20% of the population received 4% of the country's income, while the richest 20% of the population received 49.1% (United Nations, 2005). Sixty-three percent of the population lived in urban areas. Poverty affected 63% of the population. According to unofficial data, approximately 2 million Bolivians lived abroad. Argentina was the country with the largest Bolivian community (1.5 million), followed by the United States with 250,000 and Spain with 150,000. The unemployment rate in Bolivia reached 9.2% in 2005. The informal sector's contribution to the employed population was 83%. Its contribution to the gross domestic product was approximately 25%.

## 2. Microfinance in Bolivia

As a product of the economic policies applied in Bolivia in the mid-1980s, numerous contingents of unemployed people joined

the so-called informal sector made up of micro, small, and medium (MSM) enterprises. This sector did not qualify for formal banking credit, primarily for three reasons: (1) the lack of collateral; (2) the non-existence of accounting records, which made it difficult to economically and financially evaluate the customer; and (3) problems of scale because lending very small amounts of money meant very little profitability due to the cost of each transaction. To confront this situation in the late 1980s, the first non-profit organizations (NGOs) arose in Bolivia. Its objective was to provide loans to micro-enterprises, with donations and subsidized funds as its primary funding source.

In mid-1990s, two facts marked the beginning of the process to incorporate regulated financial entities that were dedicated to the MSM sector. In 1992, Banco Solidario S.A. (BancoSol), which had arisen from the PRODEM NGO, was incorporated as the first bank in Latin America that was dedicated exclusively to the MSM sector. In 1995, the government issued Supreme Decree No. 24,000, which set the norms for creating private financial funds (FFPs) and explained how they would function as specialized financial brokers in providing services to micro- and small borrowers.

Taking advantage of the new norms, several NGOs incorporated as FFPs (Caja los Andes, FIE, PRODEM, and Ecofuturo). Other FFPs arose from totally private entrepreneurial initiatives (Fassil and Fortaleza). The main advantages of becoming a formal entity were access to larger financing sources for institutional financiers through direct public funds deposit instruments and access to information from the Central Risk Offices at the Superintendence of Bank and Financial Entities.

The FFPs kept the institutional mission of the NGOs from which they arose. Their main objective was to provide greater economic opportunities for low-income earners but in a sustainable and permanent way, not as a short-lived achievement that depended on subsidies.

Between 1996 and 1998, several financial entities began to aggressively promote consumer loans. The credit agents at these institutions, who received a commission for increasing their portfolios, were mostly preoccupied with this benefit but did not properly measure how the loan would be repaid. Since the consumer customer market was limited, they made contact with micro- and small entrepreneurs and began to offer them large loans that surpassed normal amounts. Many micro-entrepreneurs went into excessive debt and, over time, could not pay off their old or new debts.

The excessive indebtedness of many micro- and small businesses would have been of no consequence if their income levels had remained stable. However, as a result of the economic crisis, Bolivia began to suffer in early 1998, as its income generation capacity decreased significantly. Associations of small borrowers were created in several regions, and these associations adopted and used pressure tactics (e.g., marches and blockades) on financial entities and government offices. The microfinance institutions held meetings with these associations and their legal advisors to clarify these situations and ask for lists of consumers who were in arrears to negotiate the most appropriate solution.

In early 1999, the Superintendence issued new regulations to limit excessive indebtedness. A key component in these regulations was that debt should be limited to 25% of salaried workers' verifiable incomes. Between 1999 and 2000, the more important consumer credit entities stopped financing micro-entrepreneurs.

Although Bolivia's political and economic crisis continued in subsequent years, the financial sector that specialized in microfinance had been able to consolidate its market position. The credit portfolios of these institutions showed major growth in 2002, 2003 and 2004, as did the number of customers served and their service coverage. Several of these institutions had been able to attain delinquent loan rates that were lower compared with those of the formal banking system, which was accompanied by greater solvency and profits (see Table 1).

**Table 1**  
Customers and branch number evolution.

	1998	1999	2000	2001	2002
Urban customers	206,869	259,258	206,984	212,010	198,281
BancoSol and FFP	165,872	217,982	165,418	165,795	144,970
Financial ONG	40,997	41,276	41,566	46,215	53,311
Rural customers	144,661	159,270	145,298	130,780	137,049
BancoSol and FFP	5121	6364	34,196	29,178	27,822
Financial ONG	139,540	152,906	111,102	101,602	109,227
Total	351,530	418,528	352,282	342,790	335,330
Urban branches	103	162	157	148	183
BancoSol and FFP	73	98	92	92	110
Financial ONG	30	64	65	56	73
Rural branches	124	129	135	142	158
BancoSol and FFP	9	8	48	47	44
Financial ONG	115	121	87	95	114
Total	227	291	292	290	341

Source: Superintendencia de Bancos y Entidades Financieras y Finrural

Financial system indicators of delinquency, solvency and profitability

	1999	2000	2001	2002	2003	2004
<i>Portfolio in arrears/gross portfolio</i>						
FFP	6.35%	9.14%	12.13%	7.20%	4.83%	3.06%
Banking system (1)	6.69%	11.55%	16.25%	17.94%	17.14%	14.50%
BancoSol	7.02%	12.33%	14.65%	9.46%	6.82%	4.21%
<i>Reserve created/portfolio in arrears</i>						
FFP	86.01%	85.27%	108.71%	132.84%	168.22%	159.61%
Banking system (1)	54.83%	54.09%	56.11%	64.38%	75.04%	85.51%
BancoSol	100.02%	78.62%	72.48%	91.2%	104.3%	119.3%
<i>Return on equity</i>						
FFP	N.A.	3.8%	1.0%	4.0%	12.7%	15.8%
Financial system (1)	8.35%	−9.60%	−4.26%	0.72%	2.83%	−1.18%
BancoSol	9.00%	3.95%	0.46%	1.71%	13.3%	20.9%
<i>Total public deposits (thousands of US \$)</i>						
FFP and BancoSol	84,836	116,289	142,572	167,426	213,778	270,399
Financial system (1)	3,464,981	3,387,030	3,123,832	2,718,262	2,612,495	2,451,909

(1) Not including BancoSol.

Source: Superintendencia de Bancos y Entidades Financieras.

## 2.1. Credit methodologies

The primary methodologies used in relation to the informal sector were savings and loan associations, individual credit, and community banks. The primary characteristic of solidarity groups is their use of an intangible guarantee. This type of guarantee means that all group members (3 to 6 people) commit to being liable for any possible default on payment by one of its members. The solidarity group as a whole becomes the borrower. The credit granted is sequential, as the group starts receiving small amounts of money that grows as a function of meeting the group's obligations. Ranging from personal to mortgage loans, individual loans use a variety of guarantees, making it possible for customers to create their own business plans in line with the activity performed.

A community bank is a group of people who are responsible for managing and returning granted funds. The Executive Institution (which grants the loan) organizes community associations. Each community bank appoints a credit committee to handle an external account, which is made up of funds granted by the Institution, and an internal account with bank members' funds. The internal account funds are generated from two sources. The first source consists of the savings of community bank members, which is required to be able to access credit. These savings are deposited into a bank account in the financial system in the community bank's name. The second source consists of interest that is generated on the external account during the loan cycle (approximately two months). Once the Executive Institution funds are received, they are circulated permanently among the community bank borrowers, as they make weekly payments to principal and interest.

These funds are again loaned to customers, thus making it possible to capitalize the external account.

## 2.2. Primary financial institutions

In addition to BancoSol, the primary regulated microfinance institutions in Bolivia are Banco Los Andes ProCredit, FIE FFP and PRODEM FFP.

In 1995, Caja Los Andes was the first PFF created in Bolivia. It began operations in July 1995, based on the ProCredit NGO credit portfolio, activities, and technology. Its primary objective was to contribute to the economic and social development of lower-income earners by providing financial services that supported MSM enterprises and improved families' quality of life. In January 2005, Caja Los Andes began operating as Banco Los Andes ProCredit and had equity of approximately US \$15 million. The bank was part of the Grupo ProCredit, a financial institution network with 18 members in countries in Eastern Europe, Latin America and Africa. As of mid-2005, the bank had various credit products, including micro-enterprise loans from US \$50, micro-enterprise lines of credit for working capital up to US \$12,000, loans to small and medium enterprises up to US \$750,000, housing loans, and loans backed by security instruments. Likewise, it offered non-credit services, such as national drafts and transfers, public utility and service payments, and debit cards. It had 37 branches spread across La Paz, Santa Cruz, Cochabamba, Tarija, Sucre, Potosi, Trinidad, and six intermediary cities. Close to 800 people worked at the bank.

The Private Financial Fund for Promoting Economic Initiatives (FIE FFP) arose with the support of the FIE NGO, which belonged to the

Swiss Agency for Aid and Development (COSUDE) and Bolivian investors. In 1998, it obtained a license to operate as a Private Financial Fund. In late 2004, it provided services to MSM enterprises through 33 offices in La Paz, Santa Cruz, Cochabamba, Potosi, Tarija, Sucre, Oruro, and three intermediary cities. The main FIE FFP products were lines of credit for micro-entrepreneurs, consumer loans, housing loans, and small and micro entrepreneur loans. The average portfolio term was approximately 16 months. The bank lending rates ranged between 18% and 30%, depending on the amount, guarantee, and terms. The institution's primary funding sources were public and commercial banking obligations.

The Foundation for the Promotion and Development Microenterprise (PRODEM) FFP began operations as a Private Financial Fund in mid-1999. It had been created based on the 13 years of experience of PRODEM, whose mission at that time had been to provide financial support to nine Bolivian departments through 75 branches (20 located in urban areas and 47 in rural areas). The primary credit product was targeted at MSM enterprises and professionals who worked on their own. The loans were for up to US \$7000, with terms of up to two years for working capital and up to three years for capital investment.

### 3. BancoSol

In 1984, ACCION International, an NGO with offices in the United States and operations throughout Latin America, recruited a group of influential Bolivians to head the creation of a micro-enterprise development program. As a result, in 1986, ACCION International created PRODEM as a co-investing foundation among members of the Bolivian entrepreneurial community, who provided the start-up capital and leadership, and ACCION, which provided the program with technology and credit methodology. Initially, PRODEM had 15 employees at its headquarters in La Paz.

PRODEM offered loans to solidarity groups. Payable weekly, the initial loans could be for up to \$50 at a 2.5% monthly interest on loans in dollars (and a 4% monthly interest on loans in bolivianos) for a term of two months. When loans were paid off, the subsequent limits for dollar amounts and loan duration increased.

By 1991, the foundation was covering its costs, but growth was becoming increasingly difficult. As a donor-financed not-for-profit organization, PRODEM could not legally accept deposits or take out loans in the monetary market, which left it with few funding sources: donor contributions, loans subsidized by development organizations, and portfolio earnings. The loan demand was growing at a rate of 50% and substantially exceeded the donor organizations' capacities to finance these loans. PRODEM was forced to reduce its loans.

To combat this financial challenge, the PRODEM Board of Directors proposed using a portion of the capital to launch a for-profit commercial bank. The bank would avoid the donor financing bottleneck by raising foreign investor capital, accepting deposits, and taking out loans in the open market. After lengthy discussions between PRODEM's management, Board of Directors, and donors (e.g., USAID, its most important donor) in late 1991, PRODEM decided to establish BancoSol through the following series of transactions:

- PRODEM transferred \$1.4 million of its credit portfolio and six of its most developed branches to BancoSol in exchange for 41% of the new bank's capital position.
- BancoSol put together capital from foreign investor groups, which included the Inter-American Investment Corporation (ICC, with 24% share) as the primary investor and various international NGOs (e.g., ACCION, Calmeadow, FUNDES, the Rockefeller Foundation, and SIDI). Several Bolivian business leaders and their companies acquired the remaining shares.
- Approximately half of the PRODEM staff went to BancoSol. During the transition, PRODEM provided office space, technical training, and information technology support.

On February 10, 1992, BancoSol officially opened its doors to the public in La Paz.

#### 3.1. BancoSol, 1992–2000

In the beginning, the bank only offered three products: solidarity (joint) loans, term deposits, and on-demand deposits. The products were design to be simple, to facilitate quick decisions, and to be sufficiently flexible to grow with customer needs.

The joint loans were loans extended to groups of three to six borrowers. The joint guarantee encouraged customers to partner with others who had the same credit capacity, which would make it possible for credit advisors to avoid the investigation process and to obtain real guarantees. The intent was to create homogenous groups in terms to the size of each business; the total amount to be disbursed could thus be distributed equitably among group members.

Initial loans were offered for US \$50 to US \$100 per customer for a two-month term. When this loan was paid off, the subsequent loan amount and term could be increased to a maximum of US \$5000 per solidary group for a three-year term. The process began by identifying borrowers. The bank employees did broad field work, investigating local neighborhoods, and got to know their potential customers. The loan documentation was minimal, but monitoring was intense and direct because credit advisors met weekly with each solidarity group. Payments were made on Monday, and the bank's information system identified any late payments that same night. On Tuesdays, the groups that had not paid were visited to find out when they would make their payments.

Two-thirds of the credit advisors were women, and most held university degrees in social science. The BancoSol salary structure was on a par with NGOs and other organizations in the development field. Commercial bank salaries were comparable to BancoSol salaries, but incentive payments caused commercial banking credit advisors to receive higher total compensation.

In 1992, the average loan size at BancoSol was US \$326, with a 35% interest rate (60% of the loans were in bolivianos). At other commercial banks, the minimum loan was US \$5000; the average loan was greater than US \$10,000; and the interest rate was 15% on loans in dollars (and 30% on loans in bolivianos).

BancoSol concentrated on the informal urban sector. The bank acted quickly to establish branches in the largest cities in Bolivia, opening 12 branches in 1993, 9 in 1994, and 3 in 1995. Over time, regional offices were opened in Santa Cruz, Cochabamba, Oruro, and Sucre. The National Bank Office organizational structure was made up of a general management department and four functional management departments. The bank gained immediate acceptance in the market and great financial success and was the international reference point for micro-enterprise financing. The credit portfolio grew at compounded rates of close to 40% during the 1992–1997 period.

In the mid-1990s, some of the bank's most successful customers began to leave microfinance institutions. Follow-up interviews held with the customers revealed that as the companies and customers' credit needs grew, they encountered various kinds of frustrations at BancoSol (e.g., hitting the joint loan limit of US \$5000). Approximately 30% indicated that they left due to problems in their solidarity groups. As a response, an individual loan product was introduced in July 1999 that was available to the bank's best customers. The credit limit was set at US \$30,000 with a term of up to five years.

In 1997, founding shareholder ICC, which an investor with an explicit social purpose, reached the five-year limit on its investment period, so it decided to put its bank shares up for sale. The same year, PRODEM decided to apply for a FFP license, thus becoming a direct BancoSol competitor, so it had to liquidate its shareholder position. ACCION believed that BancoSol was its most successful example and was willing to increase its investment.

ACCION, the Commonwealth Development Corporation (CDC), and various local entrepreneurs acquired the offered shares. PRODEM reduced its shares from 35% to 20% and resigned from its position on the Board of Directors.

In 1999 and 2000, the BancoSol performance deteriorated, alongside the lackluster performance in the rest of the financial sector. In late 1999, individual loans made up 31% of the bank's portfolio, with a delinquency rate of just 2.9%. The solidarity loans represented 69% of the loans, with a delinquency rate of 9%.

The Board of Directors believed that the bank was in crisis. The bank's financial performance was deteriorating, its distinctive product (i.e., the solidarity loan) was under pressure, and the Board of Directors and management were divided on how to address the situation. Attracted by the excellent returns, new shareholders supported the idea of climbing in the market by concentrating on the small and medium segments. Headed by ACCION and ProFund, another group advocated for improving the relationship with the microbusiness segment by introducing new products that were still missing in the informal sector. A group led by activists, who remained in the middle management departments, was in favor of keeping the original PRODEM formula; the Board of Directors did not support this option.

After several months of discussion, the Board of Directors proceeded with replacing the bank's upper management. In April 2000, it hired Kurt Koenigsfest as CEO and asked him to prepare a strategy to improve BancoSol's performance.

When the new management group began to analyze the BancoSol situation in mid-2000s, several problems came to light. The solidarity loan had been distorted. Several loans had real guarantees; the amounts granted within a group varied significantly; and a large number of these loans were being used for purposes that were not productive (e.g., purchasing vehicles). In addition, a large portion of the individual loans financed since 1999 had repayment problems, as the CEO revealed: "Most of our credit advisors did not have adequate knowledge to evaluate the customer's individual payment capacity. Between July 1999 and June 2000, the portfolio had more problems than BancoSol had had in all its history."

The new management found that each regional office was functioning as an independent bank. Each regional manager had total freedom in terms of purchases, hiring staff, and services. Accounting was totally decentralized, and there was no uniform rate schedule; each regional manager could set bank borrowing and lending rates at will. The bank culture was fairly informal, according to the CEO: "There were no staff vacation records, and the staff that worked more than 10 hours one day could take half of the next day off. The bank employees thought that the bonanza that had existed at BancoSol would never stop, which made them very conformist. They thought that the bank had reached the peak in the microfinance area."

The information system was obsolete and disproportionate. As needs came up in the system, patches were programmed as temporary solutions.

A chief officer of the BancoSol management team revealed the following: "The image that people had of BancoSol was of a bank that gave loans. We were only using 10% of our bank license, and the bank had stagnated with the products it had started with."

### 3.2. BancoSol, September 2000–2005

In September 2000, the shareholders, directors, and new management team participated in a meeting in which they analyzed the main problems that the management had discovered. They jointly created a new mission for BancoSol (see Fig. 1). However, internal discussions continued about the path that the bank should follow.

In May 2001, the general shareholders' meeting assigned an independent person to be the President of the Board. The new President of the Board identified the problems BancoSol faced: "The three main challenges we had when I took charge of the Board of Directors were

governance problems affecting the bank, different visions about the bank's future, and a lack of monitoring in the administration." The CEO was convinced that the profitability goal could be reached by improving the bank's relationship with the microbusiness segment, so he proceeded to prepare a strategic plan for the 2001–2005 period. He explained the plan's primary goals: "The main directives of the strategic plan that we brought up with the Board of Directors were to develop new products and services, improve portfolio quality, optimize and standardize the operating departments, and achieve cost efficiency." After several meetings, the Board of Directors decided to support the new strategy in July 2001. They would remain in the microbusiness niche, making long-term solvency a priority by sacrificing short-term profitability.

While a better monitoring and tracking tool was being researched, the Board decided to use the CAMEL methodology to evaluate bank functioning on a monthly basis. CAMEL is a financial evaluation system that analyzes a set of indicators grouped in five areas: Equity Sufficiency, Asset Quality, Administration, Results, and Liquidity. The administration had to present a report on how these indicators were changing, comparing BancoSol performance with that of the institutions that were considered its main competitors: Caja Los Andes, FIE and PRODEM. In September 2000, several changes began to take place in all of the bank's functional departments.

#### 3.2.1. Commercial department

According to the CEO, "One of the first tasks [BancoSol] carried out was to open up the bank product portfolio. For example, [the bank] found that micro-entrepreneurs needed loans to remodel their homes. Between the end of 2000 and 2001, [BancoSol] went from two to seven products that targeted microcredit, consumption, housing, and commerce". The seven products were: i) Sol Individual, loans targeting individuals, who own an economic unit so they can generate sufficient cash flow to amortize the loan and enter the microcredit market; ii) Solidario, join loans granted to micro entrepreneurs with their own business in groups of 3 or 4, with a join guarantee, shared by all and indivisible; iii) Sol Vivienda, mortgage loans for housing, targeting purchasing, constructing, improving and/or legalizing housing; iv) Sol Efectivo, loans for salaried workers; v) Sol Vehiculo, auto loans for individuals; vi) Solicita, commercial loans targeting small and medium enterprises for their commercial, production or services business; and vii) Sol de Oro, loans backed by jewels or gold. For savings products, the savings account was re-launched, and a new fixed-term deposit was launched, with interest to be paid monthly.

A series of non-credit services was developed, focusing on national and international remittances and transfers, public utility and service payments, tax collection, the provision of guarantee titles, debit cards and the installation of an automatic teller network. BancoSol signed an agreement with Banco Velox (2001) and Banco Columbia (2002) of Argentina to implement a service to send drafts and money transfers between Argentina and Bolivia. It also signed agreements with Transfer Exact (2002) and CIAXA (2004) to implement transfers between Spain and Bolivia. In 2004, it began activities with two remittance agencies in the US.

Due to product and service portfolio diversification, in early 2001, the bank saw the need to redesign its branches, implementing customer service platforms to facilitate opening accounts and providing complete information about the bank's services.

From the beginning, commercial management opted for mass communication media (e.g., radio and television) to transmit different advertising campaigns that circulated the new products and services offered by the bank. It also launched an institutional campaign that sought to change the bank's image from a single-product bank to a diversified bank, which was a revolutionary concept, as nobody in the sector believed that extensive advertising would have any effect on micro-entrepreneurs. "The campaign got the desired results," according to the national Commercial Manager.

## BancoSol Vision, Mission and Values

Mission	We are the leading bank, solvent, efficient, and profitable, supporting micro and small enterprises since 1992, allowing easy, quick access to high-quality integral financial services.	We are the top bank in providing integral financial services within the reach of people, micro entrepreneurs and business initiatives in Bolivia's majority sectors with whom we take on a high degree of commitment.	We are the bank that provides the chance to have a better future to lower income segments through access to high-quality integral financial services.
Vision		BancoSol will be the number one microfinance institution in portfolio volume and number of customers in each of the regions it operates. Its risk profile will be less than its direct competition's, with stable loan portfolio. The liability structure will be optimized through external, internal, and public funds deposit, maintaining appropriate asset/liability management. We will be the most profitable institution with the lowest operating expense against assets in the micro-finance system, supported by appropriate use of information technology. Our human resources will have the appropriate professional profiles and will have a high degree of motivation and commitment to the bank and the customer. The bank will provide incentives and develop a culture oriented toward performance and competitiveness.	Be an innovative microfinance leader and a reference point internationally and nationally, favoring development, progress, and quality of life for low income people.
Values			Service, Integrity, Reciprocity, Responsibility, Coherence, Commitment.

Fig. 1. BancoSol Vision, mission and values.

**3.2.1.1. Loans.** The Chief Credit Officer indicated that “[o]ne of the first measures taken in this department was to reclassify the loans portfolio and call each loan by its real name.” By the end of 2000, the solidarity loan only represented 34% of the total.

In January 2001, the new Chief Credit Officer, a position created to improve portfolio quality, began making changes in the credit policy guidelines. The autonomy margins for approving loans were modified that year. For example, the brand managers were authorized to approve loans with real guarantees for up to US \$8000 and without real guarantees for up to US \$6000. Automatic and manual internal controls were also implemented to facilitate closer monitoring of how the loaned funds were used and how they were performing. One of the credit department's greatest achievements was controlling the individual loan portfolio deterioration that occurred between 1998 and 2000. It had been necessary to penalize almost US \$14 million as part of the recovery strategy. This effort was achieved in the same commercial line of business without any supporting loans or shareholder capitalization.

In 2002, a new version of the credit policy manual was implemented nationally to standardize the loan process and to introduce new risk evaluation tools. The bank also developed a new credit scoring tool that year, which was oriented toward new customer selection and old customer segmentation processes. Using historical information and statistical techniques, the new system made it possible to evaluate the

potential risk in granting loans. The final result was a score that enabled the rating of credit applications in terms of the likelihood of the borrower defaulting on the loan.

In 2003, additional improvements were made to the credit manual. A new mechanism was implemented to evaluate loans by the amount ranges, creating instruments to evaluate loans of less than US \$1000, loans between US \$1000 and US \$6000, and loans of more than US \$6000. This mechanism also created analysis tools for SME loans.

The changes in credit policy and product diversification led to changes in the credit advisor profile. The new credit advisor had to have a university degree in the areas of management, economics, commercial engineering, or finance, with relevant experience in the area for at least one year. In addition, an advisor had to have certain attributes (e.g., sociability, entrepreneurialism, a personable demeanor) and have a talent for winning over customers. In 2004, the Credit Department was created to ensure compliance with the bank's credit policy, standardize credit processes and train credit managers and advisors in the field. The bank created the Methodology Process Department to check and verify that the technology tools and credit processes were properly applied in the field.

Largely due to credit policy changes and the new credit risk analysis tool, BancoSol reduced its delinquent portfolio from 12.33% in 2000 to 4.21% in 2004. In addition to efforts to improve portfolio quality, the bank increased reserve coverage in 2004.

### 3.2.2. Information systems

According to the Chief Systems Officer, BancoSol found itself “in possession of obsolete, totally decentralized equipment and systems, so the first job in the department was to centralize all the information system processes in 2002.” Two latest-generation servers were installed, making it possible to do away with the regional servers. The bandwidth was extended for data and communication flow, making it possible to consolidate and connect all online operations nationally. The Cooperative Open Banking Information System (COBIS) asset and liability software was updated to the latest version on the market.

In 2004, the operating and direct customer contact departments were modernized and standardized. More than 350 leading-edge personal computers were acquired to benefit the operations departments, credit advisors, service platforms, and the branch teller area. The Chief Systems Officer reflected on these technological updates: “Since 2004, the technology department developed several projects to be able to provide products and services of more value to our customers. We developed customer selection and segmentation scoring for our credit advisors and also provided them with portable electronic tools to facilitate promoting products and collecting and evaluating customer information. We also worked on improving connectivity with various institutions abroad to become a remittance headquarters for a large part of the national financial system. During all these years, we had to work on putting patches on the main software because the bank’s position would not allow for a large-scale investment in this area. At the end of 2002, we began working on a general replacement for the bank’s information technology system. This project will be finished in 2006.”

### 3.2.2.1. Administration and human resources.

In 2001, the administration was faced with the challenge of reducing cost and standardizing the bank’s administrative process. According to the Chief Administrative Officer, “To reduce costs, limits were established for the regional offices’ expense autonomy—any expense above US \$300 had to be authorized by the Chief Operating and Financial Officer and the CEO.” Payments for manager cellular phones were also limited to 130 bolivianos (less than US \$20) per month.

Each of the institution’s expense items was analyzed. The Chief Operating and Financial Officer explained: “For example, we found that 37 branches were leased by the bank and that close to 30 were leased at prices above the market. They were thus renegotiated with the property owners, and the expense for this item was reduced by 30%.”

Due to the divergence among regional processes, the customer service schedule, functions, roles, reporting structures, responsibilities, accounting processes, and uniform charts of account applications were standardized.

As part of the strategy, it was necessary to add new functional departments and reinforce the existing ones. For example, in January 2001, BancoSol created two new positions: a new Chief Credit Officer and a Deputy Chief of Credit Risk.

All changes made in these years caused deterioration in the operational climate, so the new CEO organized a series of workshops at all regional offices to communicate the bank’s new strategy and values. These high-impact training workshops were vivid and dynamic because they did not follow the typical formal academic routine, using low and high ropes courses and leadership and teamwork workshops.

**Table 2**  
BancoSol performance indicators.

	1999	2000	2001	2002	2003	2004
<i>Capital</i>						
Equity (millions of US \$)	14.3	14.6	14.5	14.8	16.8	18.6
Equity/assets	14.5%	15.9%	14.8%	14.2%	14.7%	13.5%
Reserves/overdue 1 day or more	100.0%	78.6%	72.5%	91.2%	104.3%	119.3%
Reserves/overdue >30 days	127.9%	101.1%	83.8%	104.6%	120.0%	136.2%
Overdue/equity	40.2%	65.7%	81.7%	51.7%	37.0%	24.5%
<i>Assets</i>						
Branches (#)*	43	37	35	34	36	34
Employees (#)	629	554	506	503	581	592
Assets (millions of US \$)	99.2	91.9	98.9	104.3	114.3	138.2
Portfolio (millions of US \$)	82.3	77.8	81.1	80.9	91.2	108.6
Portfolio growth	11.1%	−5.4%	4.3%	−0.3%	12.7%	19.1%
Overdue 1 day or more/portfolio	7.0%	12.3%	14.7%	9.5%	6.8%	4.2%
Overdue 30 days or more/portfolio	5.9%	9.6%	12.7%	8.2%	5.9%	3.7%
Fixed assets (millions of US \$)	6.8	6.4	5.6	5.4	5.6	6.2
<i>Administration</i>						
Financial income/average portfolio	33.9%	30.1%	26.8%	23.9%	22.8%	22.8%
Financial expenses/average portfolio	9.6%	9.0%	7.2%	5.5%	5.1%	5.0%
Bad debt expenses/average portfolio	4.6%	5.0%	5.6%	6.4%	2.6%	1.7%
Administrative expenses/average portfolio	18.2%	15.4%	14.8%	12.4%	14.0%	13.6%
Administrative expenses/average assets	13.9%	12.8%	12.5%	10.0%	11.1%	10.9%
<i>Productivity</i>						
Number of credit advisors	242	195	159	192	217	218
Customers per credit advisor	302	313	338	265	261	304
Number of loans	30,199	35,816	39,269	36,941	39,968	46,221
Portfolio (millions of US \$)	122.5	80.8	64.4	64.8	74.1	49.8
<i>Income</i>						
Service fees (millions of US \$)	0.4	0.6	0.9	0.9	1.0	1.2
Net income (millions of US \$)	1.27	0.55	0.06	0.25	2.23	3.89
<i>Liquidity</i>						
Total public deposits (millions US \$)	54.8	54.9	61	61.9	69.7	80.8
Total number of accounts (savings + fixed term)	30,050	32,728	46,665	53,341	53,600	61,823
Total deposit growth	1.1%	0.2%	11.1%	1.5%	12.5%	15.9%
Available + temporary investments/assets	12.0%	11.2%	14.6%	17.2%	13.3%	16.4%

Source: BancoSol.



**Table 3**  
CAMEL analysis: BancoSol vs. competition.

Indices	2000				2003				2004			
	BancoSol	LOS ANDES	PRODEM	FIE	BancoSol	LOS ANDES	PRODEM	FIE	BancoSol	LOS ANDES	PRODEM	FIE
<b>Capital</b>												
(Net overdue portfolio)/equity	-2.08%	18.67%	6.70%	-0.02%	-1.60%	11.40%	15.40%	-2.20%	-8.00%	-9.50%	-9.20%	-28.50%
(Net overdue portfolio + marketable goods)/equity	8.75%	18.67%	6.80%	-0.02%	6.80%	15.10%	15.60%	-2.20%	-3.40%	-7.50%	-9.10%	-28.50%
Reserve/equity	47.16%	55.11%	30.30%	53.33%	38.60%	22.40%	23.30%	29.30%	32.50%	33.10%	39.20%	50.10%
(Assets + contingency)/equity	7.1	10.4	8.6	7.4	6.8	8.5	11.0	7.3	7.5	9.4	12.7	8.1
<b>Asset</b>												
Net overdue portfolio/gross portfolio	-0.38%	2.02%	1.00%	0.00%	-0.30%	1.60%	1.80%	-0.30%	-1.40%	-1.20%	-0.90%	-4.00%
(Net overdue portfolio + marketable goods)/gross portfolio	1.60%	2.02%	1.00%	0.00%	1.30%	2.20%	1.80%	-0.30%	-0.60%	-1.00%	-0.90%	-4.00%
Total reserve/gross portfolio	8.63%	5.95%	4.40%	7.53%	7.10%	3.20%	2.70%	4.50%	5.60%	4.30%	3.90%	6.90%
Total reserve/overdue portfolio	104.62%	74.69%	82.00%	100.03%	104.30%	66.20%	60.10%	108.10%	132.40%	140.00%	130.70%	232.40%
<b>Administration</b>												
Administrative expenses/(assets + contingencies)	9.42%	10.98%	11.80%	9.50%	11.00%	10.10%	11.30%	9.90%	9.90%	10.90%	12.70%	10.70%
Administrative expenses/total expenses	29.24%	39.36%	33.60%	20.68%	58.60%	60.90%	52.20%	57.60%	54.70%	59.40%	58.40%	54.60%
<b>Earnings</b>												
Net income/financial income	1.32%	7.38%	4.80%	12.25%	11.60%	11.00%	6.70%	15.30%	17.20%	8.50%	8.50%	15.80%
Financial income/(assets + contingencies)	18.14%	19.65%	18.70%	19.37%	18.00%	16.50%	15.40%	18.10%	18.20%	17.00%	18.20%	20.20%
Net income/(assets + contingencies)	0.24%	1.45%	0.90%	2.37%	2.10%	1.80%	1.00%	2.80%	3.20%	1.50%	1.60%	3.20%
Net income/equity	1.71%	15.13%	7.80%	17.63%	13.30%	15.50%	11.40%	20.30%	20.90%	12.40%	18.60%	24.70%
Other net operating income/financial income	4.65%	4.34%	8.40%	4.47%	6.50%	3.00%	11.50%	7.20%	6.50%	4.10%	12.70%	7.60%
<b>Liquidity</b>												
(Cash + temporary investment)/short-term liability	119.86%	99.29%	62.60%	164.36%	73.40%	116.70%	56.20%	96.30%	147.90%	181.90%	99.70%	116.40%
Cash + cash equivalents/public liability	9.18%	6.62%	7.20%	4.94%	4.90%	7.70%	7.10%	11.80%	8.40%	7.90%	9.30%	14.60%
(Cash + temporary investment)/total liability	20.07%	9.45%	12.10%	8.76%	15.50%	13.70%	12.90%	13.10%	19.00%	14.30%	13.80%	12.60%

Strategic Map

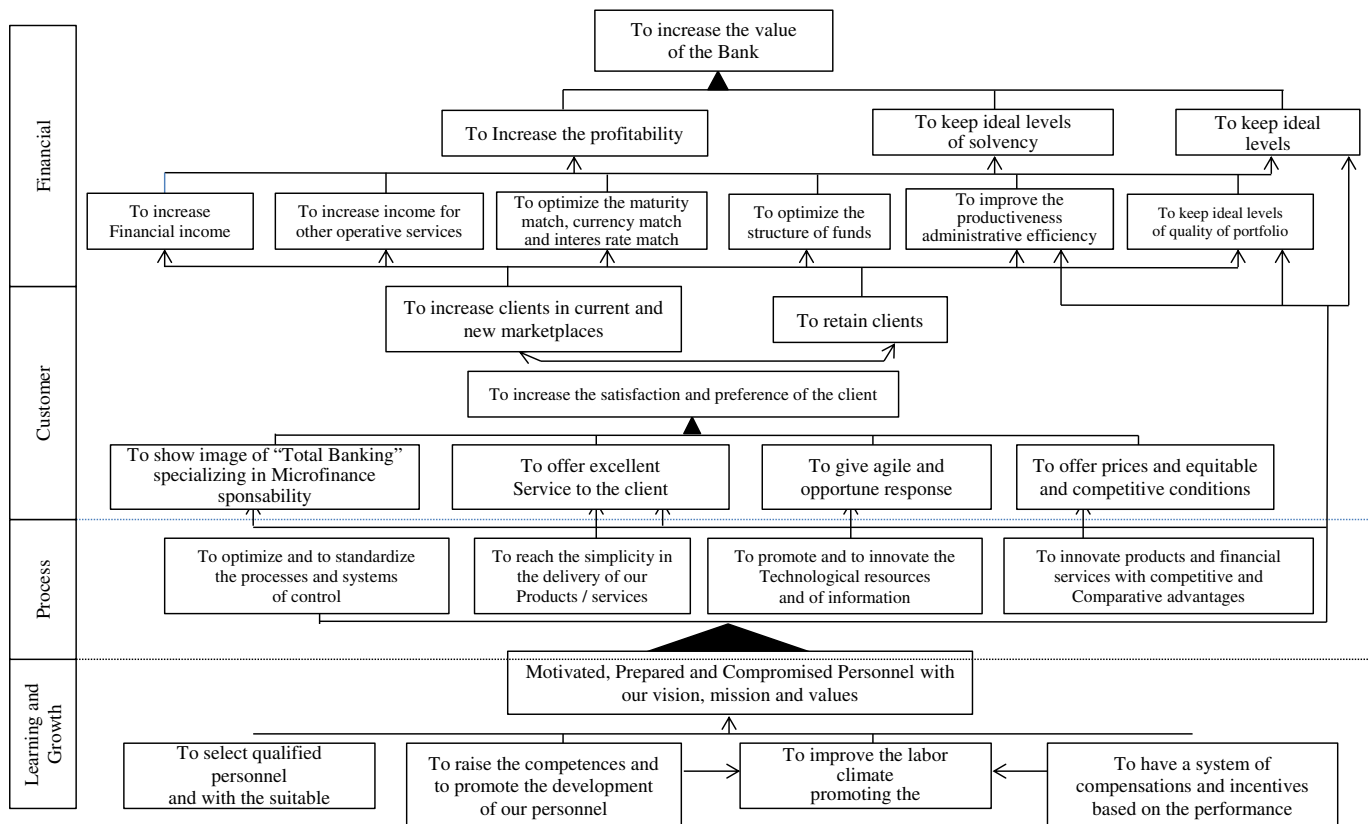


Fig. 2. Strategic map.

The Human Resources Department put together a series of training sessions each year about customer service quality, financial analysis, scoring, products and services, credit risk analysis, the bank's credit processes, and the new version of the credit policy. The CEO said that BancoSol "started training all staff members who wanted to continue with (the bank) so that they could perform their duties in line with the changes."

3.2.2.2. *Finance and control.* As for liquidity indices, BancoSol kept liquidity levels above the national banking system average in the latter years. The decision to maintain these levels was in response to the strategy that was designed to help the bank be prepared in case of any contingency and potentially provide an immediate response to customers who were withdrawing their funds.

As the CFO explaining, "People thought that micro-entrepreneur did not save. Nevertheless, in the periods of crisis, they brought their money to the bank as a means of protection, while the rest of the banking system showed a major fund outflow." As part of its strategy, the bank reduced its financial costs by changing the funding structure and reached 70% in public deposits in savings and term accounts in 2004. The improvements in the operating, commercial and credit departments bore fruit. Profits for 2003 reached US \$2.23 million (see Table 2) and had a return on equity of 13.3% higher than Caja Los Andes and PRODEM (see Table 3).

In early 2004, the Board of Directors decided to use the Balance Score Card as a monitoring and tracking tool. Along with the administration, the directors proceeded to prepare a strategic map, suggesting that objectives

and indicators be evaluated from the perspective of learning, growth, internal, customer, and financial considerations (see Figs. 2 and 3).

3.2.3. *Social responsibility*

In 2004, BancoSol shareholders and top management decided to complement the financial results with social impact indicators. The following elements were introduced into the institutional culture: i) endure value in the products and services, manifested by satisfaction and quality, ii) maintain active participation in the community served throughout the country, iii) participate actively in caring for the environment and creating an ecological awareness among our customers and employees, and iv) facilitate and empower the development of all BancoSol's employees, with equal opportunities and conditions for all. As part of its social responsibility initiatives, the bank promoted professional development of its employees. For example, in 2004, 7 employees received a post-graduate degree, 5 employees finished their graduate degree, and three finished their Master's degree.

With ACCION's technical support, the bank was able to develop a report model called the Social Score Card. The purpose of the instrument was to monitor progress for poor customers and consisted in measuring customer poverty through the income and expense variables for customers' homes. The information was obtained during the credit evaluation process for each customer (see Table 4). In addition in mid-2004, the bank evaluated more than 9000 customers who, in January 2000, applied for microcredit. The results showed that 41% of these customers improved their income and 28% maintained it. For the future, the bank's

Profit and Loss indicators

Objective	Indicator
Financial Perspective	
Increase Profits	Net income / Average equity (ROE)
Maintain optimum solvency levels	Net overdue portfolio / equity
Maintain optimum liquidity levels	Available funds / public liabilities
Increase income from other operating services	Other net operating income / financial income
Increase financial income	Income per portfolio / average gross portfolio
Optimize matching terms, currencies, and rates	Average match weighted by term
Optimize funding structure	Financial expenses / deposits with average cost
Improve productivity and administrative efficiency	Administrative expenses / average gross portfolio
Maintain optimum portfolio quality levels	Net overdue portfolio / gross portfolio
Customer Perspective	
Increase customers at current and new locations	Market share
Keep customers	Customer desertion index
Show the image of Total Banking specialized in micro finances and having social responsibility	Top of mind (with all mentions)
Provide excellent customer service	Ratio of perception about service in the teller area
Provide efficient, quick, and timely response	Number of days until disbursement for loans for less than US\$ 1,000
Offer equitable, competitive prices and conditions	Ratio of perception about interest rate in relation to value received
Internal perspective	
Optimize and standardize internal processes	Number of optimized processes
Attain unaffectedness and simplicity in delivering our products and services	Number of exclusive customers / total customer
Empower and innovate technological information resources	Bank automation level
Innovate financial products and services with comparative and competitive advantages	Number of new products or services / total products and services
Learning and Growth Perspective	
Select qualified personnel with the appropriate profile	Number of staff members with degrees/ number of employees
Elevate competences and promote staff development	Average training time per employee
Improve the work climate, promoting communication and teamwork	Turnover index
Have a performance-based compensation system and incentives	Number of staff members under the compensation floor

Source: BancoSol

Fig. 3. Profit and loss indicators.

**Table 4**  
BancoSol social score card.  
Source: BancoSol.

Statistics by poverty level	% of customers	% of portfolio balance	% new customers	Average monthly home income (in US \$)	Average loan amount (in US \$)	% portfolio at risk (overdue >30 days)	% savers
Level 1 Poor customers <sup>a</sup>	54.6%	50.3%	57.6%	336.69	3.411	3.5%	20.2%
Level 2 Vulnerable customers <sup>b</sup>	16.1%	16.7%	16.0%	455.68	3.928	2.9%	25.5%
Level 3 Not poor <sup>c</sup>	29.3%	33.0%	26.4%	591.99	4.237	3.0%	30.7%

<sup>a</sup> Customers below the poverty line.

<sup>b</sup> Customers up to 50% above the poverty line.

<sup>c</sup> Customers more than 50% above the poverty line.

directors wanted to place some indicators on the Balance Score Card to be able to monitor bank's social actions.

#### 4. Future challenges

In December 2004, the investment period for several shareholders ended. The shares of ACCION investment, Mi Banco del Peru, a group of Argentinean investors and member of BancoSol management acquired more shares. The year 2005 brought major challenges for BancoSol. "We have to understand the setting where BancoSol operates and adapt to its changes. For example, the microfinance industry is an industry that grows in period of crisis. Several opportunities appeared before us to increase market share, we can grow in the rural area or in the SME segment, or find a way to provide to Bolivian emigrants abroad," the President of the Board of Directors reflected.

Kurt and his team had to come up with a strategy for the next three years for the next Board of Directors' meeting. How can you achieve leadership in the microfinance segment when competition is more aggressive? How do you grow while maintaining your mission to serve the low-income sectors with huge social impact and at the same time continue to be profitable? There were the main questions they had to answer.

#### Appendix 1. BancoSol S.A. The recovery strategy, 2000–2004. High reliability organizations analysis.

Since its creation in 1992, BancoSol was ranked as the number one institution in the microfinance market in Bolivia, growing rapidly during the period 1992–1997. In the late 90s, high supply of microfinance services led to indebtedness of many micro and small entrepreneurs. Additionally, the country entered an economic crisis in 1998. Given the instability of their income, many micro and small entrepreneurs were unable to pay its debts. During 1999 and 2000 BancoSol performance deteriorated and the Board of Directors felt that the Bank was in crisis. BancoSol then showed three characteristics of the *High Reliability Organizations* (HRO) (Weick, Sutcliffe, & Obstfeld, 1999): *Commitment to resilience, deference to expertise and preoccupation with failure*.

In late 2000, the Bank began its transformation with a strategic planning process. During the formulation and implementation of its recovery strategy (2000–2004), BancoSol developed one of the principles of the HRO, commitment to resilience. The Board of Directors and top management analyzed and faced their mistakes and learned from them. The commitment to resilience was evident from the very top of the organization. The strategic changes are more effective if they are in these guided and are committed to the highest hierarchical levels (Golden & Zajac, 2001). The Board of Directors, aware of the challenges, decided to invite and appoint as its President an outside person with extensive experience in the microfinance area. The Board also defined a new mission that would guide the institution in the process of change. These actions have theoretical and empirical support in the literature of strategy. More diversity on boards is associated with a greater likelihood of strategic change (Goodstein, Gautam, & Boeker, 1994). In

addition, there is evidence in the literature that more power given to a person outside the organization is related to the magnitude of strategic change (Gibbs, 1993). The new management made major changes in all the main areas: credit, information systems, marketing, and human resources. In the marketing area, they realized that the bank was not fully using its license focusing on a couple of loan products and no longer responding to customer demand and the economic environment of the country. The management decided to open its product portfolio from two to seven products credit and add several non-credit financial services such as remittances and transfers. In the area of credit they proceeded to change credit policies and gave more autonomy to agency managers. This is another feature of the HRO, deference to expertise. Since the branch managers knew more about the features and opportunities of microfinance institutions in their regions, they were able to make reasonably credit decisions. Senior management delegated agency managers the approval of loans for amounts up to \$6000. In the area of information systems the bank proceeded to centralize IT processes and provide to credit advisors equipment and the latest generation software for better decision-making. During this period, the Bank demonstrated its ability to adapt and recover to position itself as the best institution in the Bolivian financial system in 2004.

The recovery process led BancoSol to develop another principle of the HRO, preoccupation with failure. In late 2004, the General Manager of BancoSol and his team analyzed and developed the Bank's new strategy for the coming years. This time was no longer a reactive process, they wanted to anticipate problems. The top management was cautious with their success and wanted to be prepared to face the changes in the environment looking for opportunities for improvement.

#### Appendix 2

BancoSol S.A.

The recovery strategy, 2000–2004

Teaching note

Authors: Luis Noel Alfaro, Karina Caballero, Mauricio Melgarejo, Enrique Ogliastrri

##### 2.1. Case study overview

BancoSol was established as the first Latin American bank specializing in serving micro-entrepreneurs. Since its onset in La Paz, Bolivia, in 1992 it had achieved excellent results, becoming an international microcredit benchmark. However, by mid-2000 its performance declined due to external and internal factors. As a result, BancoSol's management team launched a strategy leading BancoSol to be rated as the best bank in the Bolivian financial system in 2004. This strategy relied mainly on developing new products and services, improving portfolio quality, optimizing and standardizing operations, and achieving cost efficiency.

In 2005 BancoSol had several opportunities to enlarge its market share by growing either in rural areas or in the SMEs sector or by finding ways to extend credit to Bolivian migrants at their destinations.

2.2. Teaching objectives

- a. Analyzing the effect on BancoSol's strategy resulting from changes in customer preferences and the external environment.
- b. Assessing how BancoSol measures the social impact of its activities.
- c. Assessing the effect of changes in BancoSol's strategy on its performance in terms of financial inclusion.

2.3. Guiding questions

- a. What were the main causes leading to a decline in performance in both the microfinance industry and at BancoSol S.A.?
- b. Why did the new strategy succeed? Can competitors replicate/emulate BancoSol strategy?
- c. What course of action must BancoSol take to keep growing?
- d. Are BancoSol's CSR measures adequate to evaluate corporate social responsibility?  
What indicators must be added to the Balanced Scorecard to properly monitor BancoSol's social performance?
- e. What was the effect of changes in BancoSol's strategy on its performance in terms of financial inclusion?

2.4. Case study analysis (80 min)

Question # 1: What were the main causes leading to a decline in performance in both the microfinance industry and at BancoSol S.A.?  
(10 min)

In the early 90s BancoSol was the only regulated bank in the microfinance industry. Then the Private Financial Funds Act (Ley de Fondos Financieros Privados, FFPs) went into effect, resulting in lower barriers to entry in the industry, increased supply of microfinance services, more competition, and lower interest rates (via market, not decree). Then Chilean suppliers of consumer credit entered the market and targeted the clients of microfinance institutions, leading to over-indebtedness of clients and a decline in debt collection. In this context some institutions began using "harsh collection techniques" which resulted, among other things, in the emergence of debtor associations.

As a result of the arrival of new competitors offering consumer credit, customers' tastes and preferences changed from solidarity groups to individual loans.

Question # 2: Why did the new strategy succeed? (30 min)

BancoSol's initial strategy was implicit rather than formal. Since it was the first microfinance institution regulated in Latin America, growth in the early years was easier, since there was little competition. Process flexibility and informal culture allowed BancoSol to provide customized, agile loans to customers. However, a combination of crisis and economic uncertainty, increased competition, and BancoSol's own growth made it necessary to develop a new strategy.

Key competitive elements in BancoSol's strategy included,

1. Adjusting BancoSol's mission and vision.
2. Diversifying products and customizing product portfolio.
3. Diversification market segment.
4. Improving operational procedures.
5. Changing image and positioning BancoSol.

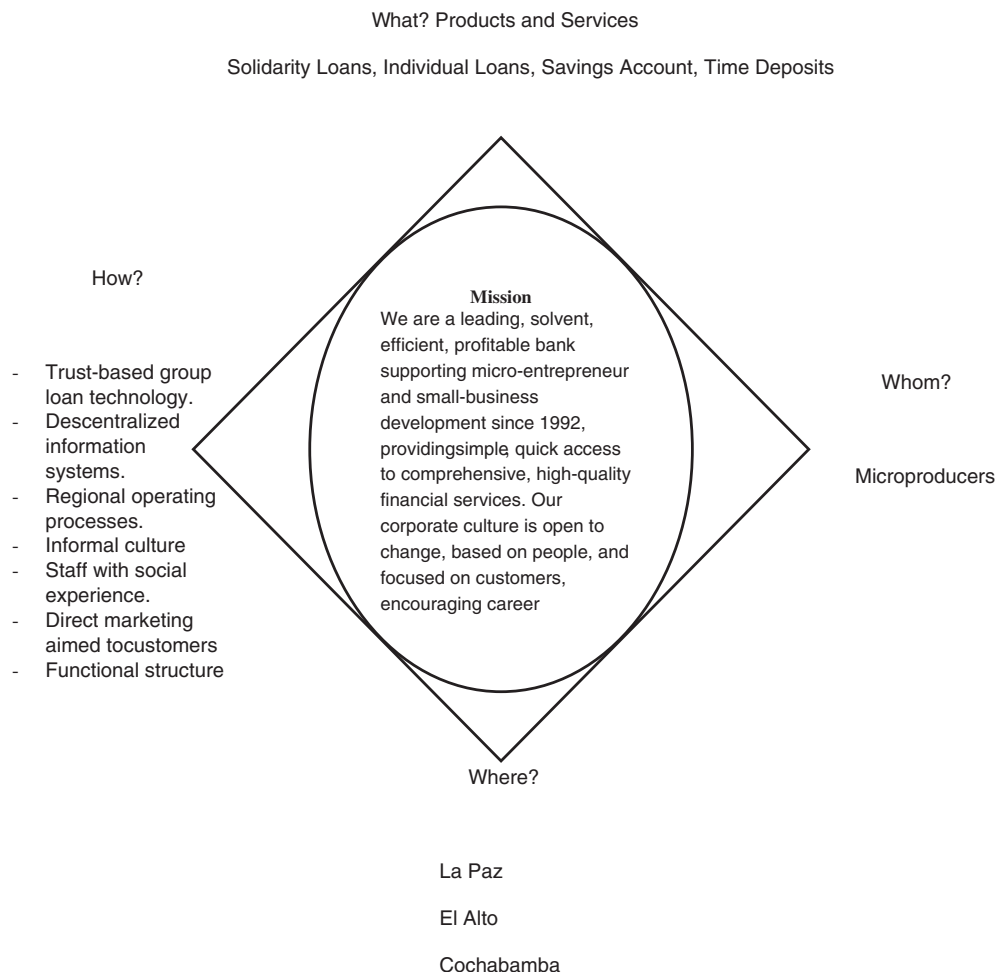
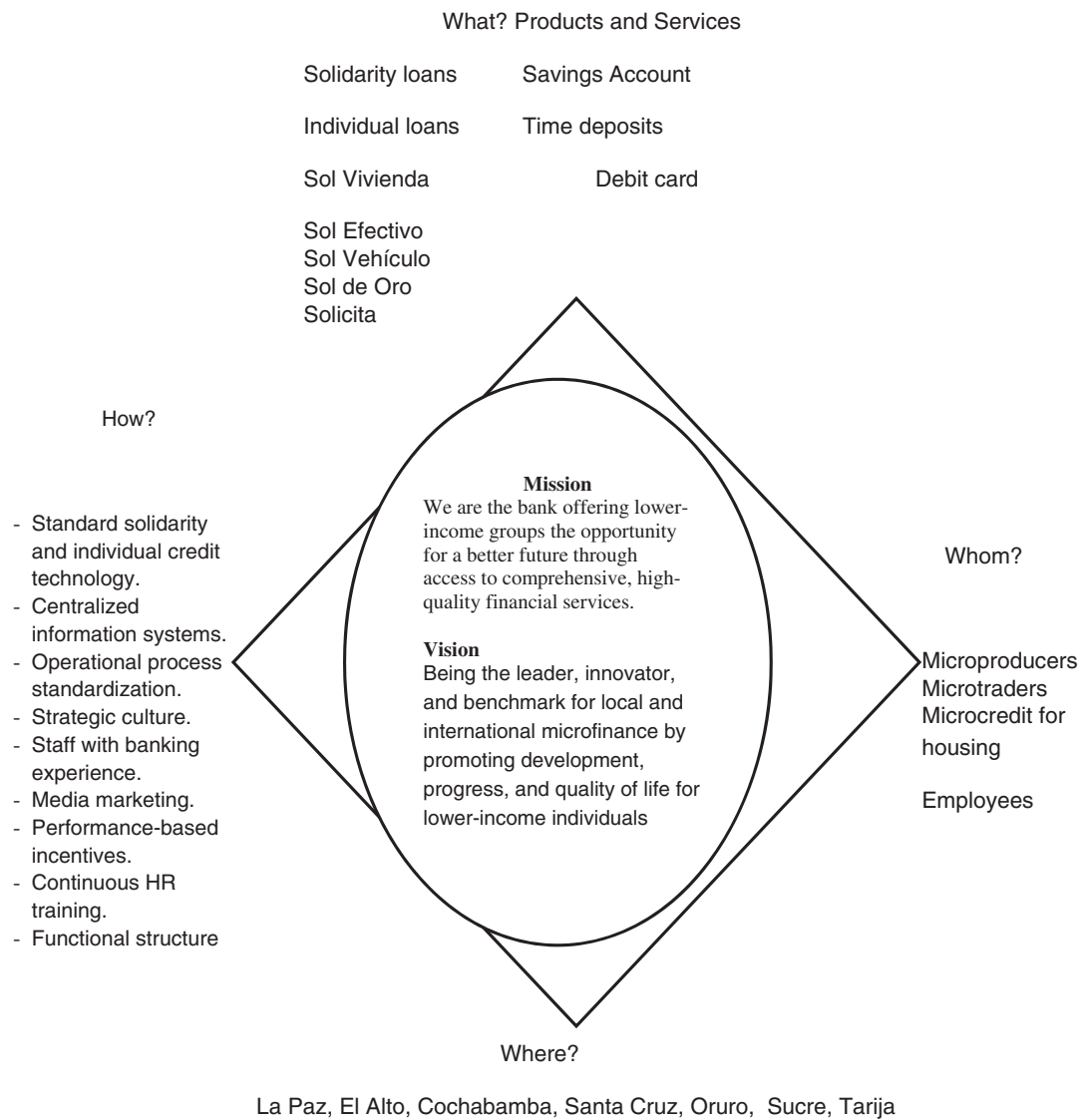


Fig. 1. BancoSol – strategic diamond diagram 1992–2000.



- 6. Using differentiation strategies as key development approach.
- 7. Developing staff.

BancoSol's new strategy was successful as all five elements in the Strategic Diamond (Alfaro, 2003) were consistent with each other and with changes in the environment (change in customers' preference from solidarity groups to individual loans), enabling BancoSol to offer a wide range of products and services through more productive, efficient, agile processes. These changes helped BancoSol increase its return on equity from 3.95% in 2000 to 20.9% in 2004. Figs. 1 and 2 display the Strategic Diamonds before 2004 and after 2005.

Question # 3: Can competitors replicate/emulate BancoSol strategy? (5 min)

Banking products are intangible and easy to emulate so product diversification was not the core of BancoSol strategy. Rather, its centerpiece was changes to internal factors (human resources, information systems, process automation and standardization, funding structure, and so on) which allowed BancoSol to attain higher ROE than its main competitors.

Even though this strategy can be effective in the short term, in the medium term it can be emulated by rivals, so BancoSol only had just a first mover advantage. However, a benefit BancoSol highlighted was the fact that its bank license allowed it to engage in non-lending operations that its FFP-licensed competitors could not perform. This

advantage was not sustainable, though, as Caja los Andes became a licensed bank in January 2005.

To maintain its competitive edge BancoSol had to continually improve, refine, and innovate operations, and stay open to new changes in resource management. It needed to avoid stagnation, analyze changes in both the market and its own environment, and remain sensitive in order to respond to changes by adapting its own structure.

Question # 4: What course of action must BancoSol take to keep growing? (5 min)

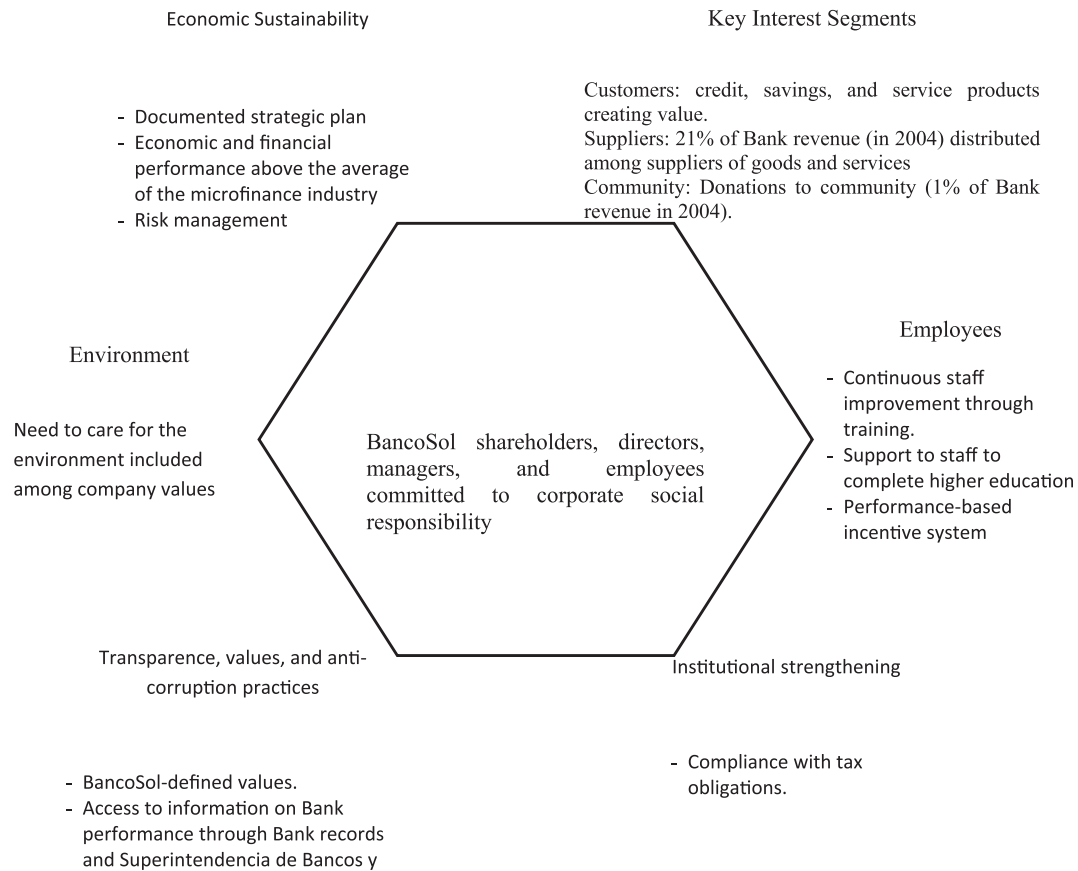
Evidence from the case indicates that most of the growth in the microfinance market was taking place in rural areas and loans to small and medium-sized entrepreneurs. Since BancoSol had no presence in these segments, there were growth opportunities to be pursued there.

2.4.1. Advantages fostering BancoSol's growth in SMEs and the rural sector

- Rural areas not yet fully served by financial organizations. Wide range of BancoSol products and services.
- Good local image. Strong capital structure. Highly-qualified staff.

2.4.2. Disadvantages hindering BancoSol's growth in the rural sector

- Lack of coverage in intermediate cities and the rural sector. No loan technology developed for SMEs and rural microcredit. PRODEM



**Table 1**  
 Financial inclusion: BancoSol – 1999–2004 performance indicators.

	1999	2000	2001	2002	2003	2004
<i>Extent of outreach indicators</i>						
Volume of loan portfolio (US \$ M)	82.30	77.40	81.10	80.90	91.20	108.60
Number of borrowers	73,073	67,082	61,338	50,904	42,831	71,609
% of population with access to BancoSol loans	0.9%	0.8%	0.7%	0.6%	0.5%	0.8%
Volume of deposit portfolio (US \$ M)	54.80	54.90	61.00	61.90	69.70	81.50
Number of depositors	32,748	30,004	43,698	48,341	N.A.	N.A.
% of population with access to BancoSol S.A. savings accounts	0.4%	0.4%	0.5%	0.5%	N.A.	N.A.
Share of the deposit portfolio in total liabilities	64.6%	71.3%	79.7%	73.9%	71.6%	68.1%
Total of active/passive customers	105,821	97,086	105,036	99,245	N.A.	N.A.
% of population with access to savings and loan service	1.3%	1.1%	1.2%	1.1%	N.A.	N.A.
Income from other services (US \$ M)	1.70	1.40	2.30	1.60	2.10	2.60
Income from other services/total income.	6.9%	5.4%	11.0%	8.1%	10.0%	10.0%
<i>Depth of outreach indicators</i>						
Average loan size	1126.09	1154.56	1212.8	1487.7	2126.01	1517.89
Percentage of women among total borrowers	74.0%	63.0%	60.0%	68.6%	54.9%	49.7%
Average size of deposits (US \$)	1673	1830	1396	1280	N.A.	N.A.
<i>Convenience indicator</i>						
Number of points of service	43	37	35	34	36	34
<i>Quality indicators</i>						
Growth of loan portfolio	11.1%	-5.9%	-4.0%	1.8%	20.2%	19.4%
Growth of deposit portfolio	1.1%	0.2%	11.1%	1.5%	12.6%	16.9%
Effective lending rate	28.4%	30.6%	25.6%	24.4%	21.1%	21.1%
Effective deposit rate	8.6%	10.3%	8.5%	6.3%	6.0%	6.2%
PAR >30 days	5.9%	9.6%	12.7%	8.2%	5.9%	3.7%
Loss rate from bad debt	0.0%	0.0%	10.6%	0.0%	2.3%	1.2%
Overhead (operating expenses/loan portfolio)	16.3%	15.2%	14.0%	12.7%	13.4%	12.5%
<i>Permanence indicators: sustainability of financial inclusion</i>						
Sustainability Index (SI) = income/expense	1.26	1.25	1.25	1.36	1.25	1.28
Return on assets (ROA) = profits/assets	1.4%	0.6%	0.1%	0.3%	1.9%	3.1%
Return on equity (ROE) = profits/equity	9.0%	3.9%	0.4%	1.8%	13.2%	22.2%

Source: Microfinance Information Exchange, Inc. [online] <http://www.mixmarket.org/mfi/bancosol/report>. Accessed November 2013.

**Table 2**  
Banco Solidario – BancoSol 2005–2012 performance indicators.

	2005	2006	2007	2008	2009	2010	2011	2012
<i>Outreach indicators</i>								
Volume of loan portfolio (US \$ M)	130.10	163.10	209.00	294.20	351.80	439.80	585.60	733.00
Number of borrowers	85,000	103,786	121,207	109,763	129,705	145,608	169,251	193,208
% of population with access to BancoSol loans	0.9%	1.1%	1.3%	1.1%	1.3%	1.4%	1.6%	1.8%
Volume of deposit portfolio (US \$ M)	97.40	146.10	169.50	261.70	342.90	420.10	536.20	634.30
Number of depositors	76,587	111,946	169,507	209,845	323,022	414,154	484,973	547,222
% of population with access to BancoSol S.A. savings account	0.8%	1.2%	1.8%	2.1%	3.2%	4.1%	4.7%	5.2%
Share of deposit portfolio in total liabilities	62.6%	72.4%	71.1%	74.1%	76.8%	77.5%	80.3%	77.2%
Total of active/passive customers.	161,587	215,732	290,714	319,608	452,727	559,762	654,224	740,430
% of population with access to savings and loan service	1.7%	2.3%	3.0%	3.2%	4.5%	5.5%	6.3%	7.1%
Income from other services (US \$ M)	2.50	3.70	5.10	2.60	2.70	1.40	2.70	1.60
Income from other services/total income.	8.7%	10.2%	11.7%	4.5%	3.7%	1.7%	2.6%	1.3%
<i>Penetration indicators</i>								
Average loan size	1530.66	1571.76	1723.99	2680.46	2712.5	3020.68	3459.66	3793.64
Percentage of women among total borrowers	48.4%	46.4%	46.4%	47.2%	48.0%	48.1%	48.1%	47.5%
Average size of deposits	1272	1305	1000	1247	1061	1014	1106	1159
Source: Microfinance Information Exchange, Inc. [online] <a href="http://www.mixmarket.org/mfi/bancosol/report">http://www.mixmarket.org/mfi/bancosol/report</a> . Accessed November 2013								
<i>Convenience indicator</i>								
Number of points of service	N.A.	N.A.	N.A.	59	53	69	70	81
<i>Quality indicators</i>								
Growth of loan portfolio	19.7%	25.4%	28.1%	40.8%	19.6%	25.0%	33.1%	25.2%
Growth of deposit portfolio	19.6%	49.9%	16.0%	54.4%	31.0%	22.5%	27.7%	18.3%
Effective lending rate	20.1%	19.7%	18.6%	18.6%	19.5%	18.1%	16.8%	17.1%
Effective deposit rate	5.8%	4.8%	5.6%	5.1%	5.1%	3.3%	2.8%	3.0%
Portfolio at risk > 30 days	3.9%	3.7%	1.0%	1.0%	1.1%	0.9%	0.8%	0.7%
Loss rate from bad debt	0.4%	0.2%	2.2%	1.2%	0.5%	0.6%	0.3%	0.4%
Overhead (operating expenses/loan portfolio)	11.7%	11.7%	11.1%	11.2%	9.9%	10.2%	10.5%	10.6%
<i>Permanence indicators</i>								
Sustainability Index (SI) = Income/Expense.	1.24	1.33	1.29	1.22	1.32	1.40	1.40	1.36
Return on assets (ROA) = Profits/Assets.	2.7%	2.3%	3.0%	0.7%	2.6%	2.2%	2.3%	2.1%
Return on equity (ROE) = Profits/Equity.	22.2%	22.8%	31.6%	8.1%	33.9%	30.1%	30.3%	28.8%

Source: Luis Noel Alfaro (2003) based on Microfinance Information Exchange, Inc. [online] <http://www.mixmarket.org/mfi/bancosol/report>. Accessed November 2013.

leadership in the rural sector. Growing competition in the microfinance sector.

Question # 5: Are BancoSol's CSR measures adequate to evaluate corporate social responsibility? What indicators must be added to the Balanced Scorecard to properly monitor BancoSol's social performance? (15 min).

The CSR Hexagon model (Ogliastri, 2003; Ogliastri et al., 2009) will be used to evaluate BancoSol social responsibility.

BancoSol's measurements of its performance in terms of social responsibility include only a few categories, that is, customers, employees, and income distribution among publics of interest (see Table 3).

In addition to pointing to BancoSol's economic performance, some indicators in the Balance Score Card can also indicate BancoSol's social responsibility. For example, the *Cash/Public Liabilities* indicator measures BancoSol's responsibility to maintain optimum levels of liquidity allowing it to respond to its depositors in case of crisis.

As a part of BancoSol's current measures of social responsibility, the following items can be added to its Balance Score Card (BSC):

- Customers: (a) percentage of poor customers (level 1), (b) percentage of new poor customers, and (c) percentage of customers who succeeded in improving their revenues.
- Suppliers: percentage of Bank revenue distributed to suppliers.
- Community: percentage of Bank revenues devoted to donations to the community.
- Employees: (a) average training hours per employee, (b) number of employees with degrees/number of employees (these indicators are already included in the BSC).
- Organizational Strengthening: percentage of Bank revenues devoted to tax payments.

Some new responsibility indicators that may be added to BancoSol Balance Score Card in various categories include,

- Suppliers: (a) percentage of suppliers engaged in social responsibility practices, (b) supplier satisfaction.
- Environment: number of environmental projects implemented (e.g., energy savings and paper savings).
- Customers: percentage of customer complaints solved.
- Transparency, values, and anti-corruption practices: (a) number of audits per year and/or audit hours per year, (b) number of employees trained in asset laundering.

Question # 6: What was the effect of changes in BancoSol's strategy on its performance in terms of financial inclusion? (10 min, including closing).

As a development finance institution, financial inclusion is a crucial issue at BancoSol S.A. We will use the conceptual framework known as the Star of Financial Inclusion, developed by Prof. Luis Noel Alfaro, to assess the effect of changes in BancoSol's strategy on BancoSol's performance in terms of financial inclusion.

First we can see that BancoSol S.A. is explicitly committed to financial inclusion; its mission clearly states the Bank's purpose to provide lower-income segments of society with access to financial services.

The data in Table 1 of this note can be used to evaluate the effect of strategic changes in BancoSol on its performance in terms of financial inclusion. Table 2 shows significant improvement of BancoSol's performance from 1999 to 2012 in every dimension of the Star of Financial Inclusion except for depth of financial inclusion; BancoSol lost depth as a result of implementing an upscaling process by moving to cater to small and medium-sized enterprises in addition to microenterprises.

## 2.5. Conclusion

According to information until 2012, BancoSol had really impressive performance in terms of financial inclusion in the following dimensions of the Star of Financial Inclusion: Extent of Outreach, Depth of Outreach, Geographic Convenience, Quality of Outreach and Permanence and Sustainability of Financial Inclusion. BancoSol S.A. received in 2008 the Award of Excellence from the Inter-American Development Bank (IDB) as the best regulated microfinance institution in Latin America.

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### Appendix 1

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