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COLOMBIAN MICROFINANCE

Kathleen Ryan

Introduction

Microfinance is the provision of financial services, such as credit, savings, and insurance services, to those who are most likely to be denied access to the traditional banking system. A typical client for a microfinance institution (MFI) is a person too poor to pay usual bank fees for savings accounts or other services or to provide sufficient collateral to back loans. Microfinance aims to bring out the skills of the poor and allow them to propel themselves out of poverty through providing financial services with which they can protect assets and grow microenterprises. MFIs have developed many innovative financial products to offer their clients beyond credit, such as microsavings, money transfer vehicles, and microinsurance. Microfinance is a growing industry throughout the developing world and comprises commercial banks, regulated banks, nongovernmental organizations (NGOs), and nonprofit organizations (NPOs). With approximately 17 million impoverished, there is a large market for the microfinance industry to capture; yet, in Colombia, it is not nearly as well established as in neighboring countries. Peru and Bolivia, for example, are among the world's most competitive and innovative microfinance markets (The World Factbook). This article tackles the question, Why is the Colombian microfinance industry lagging compared to that of some of its neighbors?

The article begins with an introduction to the Colombian economy and economic conditions in Colombia. It then outlines the history of microfinance and how it moved into Colombia. From there, the article compares the Colombian microfinance industry with microfinance industries throughout Latin America to provide a frame of reference for its development in Colombia. This comparison leads to the thesis, that the financial regulatory system in place in Colombia is restricting growth of the

microfinance industry and hindering its ability to reach the same level of development seen in Colombia's neighbors. Wrapping up the article are recommendations that may help the Colombian microfinance industry grow and provide beneficial financial services to more of those in poverty.

Colombian Economy

Microfinance aims to help alleviate poverty and provide opportunities for microenterprises to grow. Unemployment is particularly difficult to measure in Colombia due to the significant number of people employed in the informal sector (see article by Peterson in this issue). In 2011, Colombia had the highest unemployment among similarly developed countries in Latin America, at 10.8 percent. Although the overall GDP of the economy was third in the region that year, with $321 billion, inequity in the country has grown, leaving millions in poverty (The World Factbook). The World Bank's Gini index, measuring the extent to which the distribution of income deviates from a perfectly equal distribution, is 55.9 as of 2010. A perfectly equal income distribution would have a Gini index of 0. Sweden has the lowest income inequality globally, with a Gini index of 23, and the United States has an index of 45, showing how high inequality is in Colombia (World Bank). The poverty rate in 2010 stood at 37.2 percent of the population, with approximately 17 million Colombian citizens living below the poverty line (The World Factbook).

With such a high number of impoverished people in Colombia, there is a large potential microfinance clientele. In 2012, Colombian MFIs had 2.3 million borrowers and offered deposit services to 6.2 million savers (MixMarket). It is difficult to determine how many of these clients actually had incomes below the poverty line. Nevertheless, these numbers show that millions of impoverished Colombians remain without access to financial services. The microfinance industry in Colombia has a huge opportunity to serve these people and attempt to reduce poverty. However, the Colombian microfinance industry lags behind many other countries in Latin America, notably Peru and Bolivia.

History and Origin of Microfinance

One of the most difficult features about living in poverty is escaping from it. The poorest of the poor have limited access to financial outlets to borrow and save money. With credit, the poor can make large purchases for maintaining microenterprises, home repairs, or general consumption needs that are otherwise unattainable. Savings services provide the poor with safe options for accumulating wealth and help smooth consumption or help pay for large purchases or events, such as weddings or funerals. Like the rich, the poor desire insurance to help protect against the unexpected. Microfinance attempts to relieve the burden of some of these issues by providing financial services to the typically "unbankable" (Rutherford and Sukhwinder).

Reducing poverty has been a goal of many organizations across the globe, but microfinance was the first institution to offer sustainable financial products to the world's poor. Muhammad Yunus is noted as one of the first to propose that the poor may be able to pull themselves out of poverty if they are given access to credit. Yunus' first loan, a mere $27, was given in 1976 to a group of villagers in Bangladesh. This group of borrowers set the stage for Yunus' creation of the first large-scale MFI in Bangladesh, the Grameen Bank, established in 1983 (Yunus).

Although Yunus is often labeled the father of microfinance, the NPO, Accion, was actually the first to start microfinance, in 1973. Accion was founded in Venezuela by Joseph Blatchford in 1961 when he was a law student at the University of California, Berkeley. Later, Accion workers in Recife, Brazil, worked with microenterprises and issued the first experimental microcredit loan. Accion's microfinance operators have since spread, with branches not only in Latin America but also in Africa, Asia, and the United States (Accion).

Informal Banking

Microfinance has taken many lessons from informal methods of saving and lending used by the poor, such as savings clubs and moneylenders. There are two main types of savings clubs—rotating savings and credit associations and

accumulated savings and credit associations. Both use systems where each member puts a predetermined amount of money into a pot of funds and a member gets to receive this lump sum at a certain time. Accumulated savings and credit associations often act as a type of insurance because they allow members to take funds in emergencies. These informal savings clubs are generally self-managed by the involved participants and rely on social sanctions, trust, and a deep knowledge of the other group members' characters. Similarly, the use of social sanctions and community relationships have been integrated into the group lending methodology for microfinance. The nearly universal use of these informal practices throughout the developing world, particularly widespread in Africa and Asia, demonstrates the high need for financial services by the poor, especially savings, insurance, and loans (Rutherford and Sukhwinder).

Moneylenders are another informal source of credit for the poor but can charge extremely high fees for their services. Some interest rates charged by moneylenders reach as high as 50 percent per day (Robinson). There are lessons to learn from moneylenders, however, that MFIs use in their methods of lending. Moneylenders know their clients personally, which helps build trust between borrower and lender. Moneylenders are available to their clients quickly and locally in the community, a convenience to clients. Furthermore, moneylenders often have systems of increasing loan amounts with consistent repayment as a form of incentive. The high interest rates charged by moneylenders—empirical studies have found that 45 percent of money-lending rates are above a 25 percent monthly effective interest rate—prove that there is a high demand by the poor for access to credit (Robinson). These services provide great value to the poor; otherwise, they would not subject themselves to the high rates. MFIs have utilized many aspects of the informal methods while providing financial services to the poor at generally much lower rates, although still high by developed economy standards.

Microfinance in Latin America

Microfinance is in different levels of development throughout Latin America and the Caribbean. Bolivia and Peru have some of the most developed and successful MFIs in the region. Despite its proximity to both, Colombia lags in its development of microfinance in comparison. Some of the differences in microfinance development stem from the variations in economies throughout the region. Countries in Latin America are at widely different stages of economic development, requiring that MFIs have different target markets, lines of services, and regulatory frameworks.

Colombia has the potential to become one of the strongest microfinance industries in Latin America. Colombia is the third largest microfinance market in terms of number of clients in Latin America, behind Mexico and Peru (both of which have markets nearly double the size of Colombia's). Unfortunately, Colombia covers only 13.6 percent of the potential market—a small portion of market coverage compared with Peru with 26.2 percent and Bolivia with 55.7 percent coverage. In contrast, Colombia's neighbor Venezuela covers approximately only 0.8 percent of its microfinance market potential, the smallest coverage in all of Latin America. Colombia may not be in the worst position, but in a ranking on market penetration relative to full market potential, Colombia falls 14th globally in the rankings; Peru and Bolivia both secure high spots at numbers two and three in this measure (Marulanda and Otero). Clearly, Colombian microfinance has a lot of room for growth and improvement.

So what is keeping Colombia's microfinance industry from reaching the levels of market penetration found in Peru and Bolivia? One of the main differences is regulatory environments. The essential reason that regulation matters (discussed in detail later) is that it allows regulated banks to hold deposits, increases transparency, and keeps the banking system afloat. Unregulated MFIs cannot take deposits, significantly restricting the range of services they may offer and limiting an important source of funds. Throughout Latin America and the Caribbean, there are many more nonregulated MFIs than regulated MFIs. As of 2005, Latin America and the Caribbean had 98 regulated MFIs compared with 238 nonregulated MFIs. Peru is an outlier in this figure—Peru has more regulated MFIs than nonregulated, at 43 and 24 MFIs, respectively. Similarly,

Bolivia may have fewer regulated MFIs (7) than nonregulated (14) but the number of borrowers in regulated MFIs (308,978) is significantly higher than the number of borrowers in nonregulated MFIs (239,264), so the market penetration in Bolivia is done largely by regulated MFIs (Berger et al.). Colombia's microfinance industry has five regulated MFIs compared with 17 nonregulated MFIs at the time the Inter-American Development Bank took its survey in 2006; although the number of regulated MFIs has increased, the borrowers in Colombia still primarily borrow from nonregulated MFIs.

Colombia is making progress in keeping up with Peru and Bolivia by adding more regulated MFIs to the market, but many nonregulated MFIs remain hesitant to switch because of Colombia's unfavorable regulatory environment. The largest deterrent keeping MFIs from becoming regulated institutions is the interest rate ceiling, at 39.89 percent; neither Peru nor Bolivia has interest rate caps. Since 2000, Colombia has set an interest rate cap at the usury interest rate, which is defined as 1.5 times that of the current banking interest (Castellanos, p. 2). This restriction discourages MFIs from switching to becoming regulated, with Bancolombia and Banco Caja Social (BCSC) leading the NPOs (Berger et al.). The largest NGO network of MFIs practicing microfinance in Colombia is the Women's World Banking (WWB) organization, which has three branches in Colombia.

WWB is one of the largest MFIs globally. WWB operates in many countries in Latin America, including Bolivia, Brazil, Chile, Dominican Republic, Mexico, Paraguay, and Peru, in addition to its work in Colombia. WWB may be the most notable case for the difference in regulatory regimes in Colombia compared to its more developed neighbors. WWB remains an NGO in all of its branches operating in Colombia, which include FMM Popayán, Fundación WWB Colombia, and Fundación Delamujer, whereas WWB is formalized and regulated in all other Latin American countries in which it operates. WWB chooses to remain an NGO because it is afraid of "the negative effects of operating under the regulatory regime in their country, which does not have any special treatment for microfinance entities, restricts their operational flexibility, and creates an additional cost structure and risks that they do not want to assume" (Marulanda and Otero, p. 10). WWB affiliates found sufficient financing for their growth from donors and second tier and commercial banks in Colombia, allowing them to continue to lend to their clients. As long as they remain unregulated, they cannot be self-sustaining by funding through savings services they would be able to offer if they were a regulated entity.

Best Practices for Regulating Microfinance

So what might Colombia do to better foster the industry? Regulation and supervision in the financial system determine the types of permitted activities in which certain categories of financial institutions are allowed to engage. Regulations also enforce requirements on financial institutions that are intended to keep the financial system and all unintended externalities safe. The microfinance industry is unique in the financial system because of the diversity of entities that offer microfinance services. Some countries have developed unique regulatory frameworks for microfinance whereas other countries have ignored the microfinance industry altogether, restricting MFIs to remain mostly donor-driven NGOs and NPOs. Best practices for microfinance regulation and the successful regulatory regimes in Peru and Bolivia are discussed and compared with those in Colombia.

Deposits

Deposit-holding functions in MFIs are both helpful for the depositor and for the MFI itself in becoming sustainable. The depositor benefits from having a safe place to store money and accumulate savings. It is often difficult to save money when it is hidden at home because of the likelihood of people trying to steal the money. People also tend to spend their or their family member's money more when it is more easily available.

The MFI benefits from holding deposits because it can become more self-sustaining. Deposits are a low-cost source of funds to lend back to clients. Also, adding deposit-holding

services adds costs to an MFI from an increased demand for staff and for record keeping. Caudill, Gropper, and Hartarska studied the cost-effectiveness over time of MFIs in Europe and Central Asia. The results revealed a split of the MFIs into two groups: MFIs that become more cost-effective over time and those that show no improvements. The main difference between the two groups was the level of reliance on subsidies for a source of funding. Those less reliant on subsidies and more reliant on deposits were more cost-effective. The more cost-effective group had several thousand times the volume of deposits and more than five times the total assets compared to the MFIs in the subsidy-driven group. The large size of these MFIs may indicate that they are issuing larger loans and lending to more than just MFI clients, improving cost-effectiveness. The empirical results of this study suggest that an increase in regulated, deposit-holding MFIs would better enable Colombia's microfinance industry to follow the growth trends found in this study and reach more of the potential microfinance market.

Without being a regulated institution, an MFI cannot hold deposits. Compared to Bolivia and Peru, Colombia has few regulated MFIs. In Colombia, BCSC holds nearly all of the deposits, with 5.2 million depositors and a total balance of deposits of $3.8 billion. The bank's average loan is $4,739 while its average deposit balance is $739. The imbalance most likely results from offering deposits to more of the country's poor than the bank does. BCSC, a Jesuit social welfare savings bank founded in 1911, is a unique case in Colombia. It serves both low-income and medium-income Colombians, not just microfinance clients, which makes analysis of this bank difficult. By comparison, another regulated deposit-holding Colombian MFI, Bancamía, has a deposit balance of $65.6 million and 322,697 depositors. There are other deposit-holding MFIs in Colombia, but a vast majority of MFIs do not carry deposits—depriving many poor of a much-needed financial service. BCSC offering these deposits to so many of the poor is certainly beneficial to those families, but BCSC's large scale may inhibit smaller MFIs from entering the game, wary of such a large competitor. And for those that have entered, BCSC's dominance forces these small MFIs to continue to lend at a higher cost than they would be able to reach with a sound base of deposits. In Bolivia, the largest holders of deposits are BancoSol, Banco FIE, and EcoFuturo. BancoSol has 484,973 depositors with a deposit balance of $536.2 million; Banco FIE has a deposit balance of $491.9 million from 476,870 depositors; and EcoFuturo has 162,005 depositors and a balance of $110.9 million. Among these top three there is a more competitive balance with regard to depositors versus Colombia (MixMarket). Bolivia has just over 5 million citizens in poverty whereas Colombia has more than 3 times that, which explains the lower numbers of depositors comparatively in Bolivia (The World Factbook). Peru's microfinance industry is similar to Bolivia's in its spread of deposit-holding institutions. The top three deposit-holding MFIs in Peru are Crediscotia (528,876 depositors with a balance of $681 million), CMAC Arequipa (462,722; $676.4 million), and MiBanco (570,782; $1.4 billion). Comparing these figures to Colombia's Bancamía shows how much room there is for the savings sector within the microfinance industry to grow.

As in Peru, Bolivia's microfinance industry is funded mainly through deposits. After the liberalization that followed Bolivia's hyperinflation in the mid-1980s (i.e. closures of government banks and elimination of interest rate controls), the Superintendencia de Bancos y Entidades Financieras (SBEF), the Bolivian financial regulator, shifted its focus of regulation from institutional type to, instead, the characteristics of loans. This led the SBEF to reduce requirements for loan collateralization and to emphasize analysis of borrower cash flows, which encouraged more institutions to become regulated. This in turn spurred a sharp increase in depositors. The increase in competition among banks in Bolivia reduced interest rates and led to innovative lending techniques. The changes in regulatory framework and the emphasis on financial inclusion for all citizens has increased the importance of microfinance in the financial industry in Bolivia—microfinance accounts for 37 percent of all financial activity in the country (Vogel, p. 12). Since the reformation of the regulatory environment in Bolivia, the number of microfinance

depositors has soared to 2 million people. Colombia should consider following Bolivia's lead and focus its regulation on the type of services offered rather than the characteristics of the institution as a whole, which would allow more banks to offer microfinancial services, in particular savings. Bringing both savings and lending services into one bank improves convenience for clients by keeping all of their financial services with one institution.

Prudential Regulation

Prudential regulation refers to the regulations applied to institutions that hold deposits. The importance of this regulation is both to protect uninformed depositors from potential risks the deposit-holding institution is taking and to protect the deposit-taking institution against the failure to reduce potential banking collapse. Lending-only MFIs do not need prudential regulation because they are not taking others' money—depositors are safe. Prudential regulation protects the financial system from failure as a result of the domino effect of one failure leading to another failure as well as protecting depositors who do not have the ability to carefully monitor the bank themselves. The difficulty with prudential regulation for MFIs is that compliance with prudential regulation is complex, expensive, and often difficult. This is also true for the enforcement of prudential regulations where many regulators and supervisors are already understaffed or at capacity (Christen et al.).

Bank supervision has a focus on the capital adequacy ratio (CAR), which helps measure the prudential risk of an institution by calculating the ratio of equity to risk-weighted assets. The higher this ratio, the less risk there is for the financial system and depositors. However, because retained deposits are a major source of measured equity, retaining deposits also implies that there is less funding available to use for loans or other investments. As discussed previously, MFIs that are funded by more deposits have more potential for growth, in turn furthering the goal of the microfinance industry to extend the provision of financial services. The Consultative Group to Assist the Poor best practices suggest that the CAR should be higher for MFIs than typical banks for various reasons. First, because MFI loans are uncollateralized, there is nothing to back the loans in case of delinquency. The delinquency rates for microloans are notoriously low because the borrowers must pay back their loans in order to get another loan. However, studies have found that delinquency has a contagious effect: when one borrower chooses not to pay back a loan, others tend to soon follow. For instance, there have been several microfinancial crises across the globe, such as in Nicaragua, India, Morocco, and Bosnia-Herzegovina. Nicaragua dominoed into crisis in the *No Pago* political movement, where, with political support from the ruling party, borrowers collectively decided to default on their loans, a movement which spread throughout the country. India suffered a similar politically fueled repayment crisis (Chen et al.). Episodes such as these put MFIs at serious risk without a base of capital. Additionally, because the interest rates on microloans are higher than normal rates—data indicate the average rate in Colombia is around 35 percent but with a high concentration of loan products around the regulatory cap 40 percent effective interest rate—the delinquency of one loan has harsher revenue implications for an MFI than a single delinquency does for a regular bank ("Colombia . . ."). Another major reason for keeping the CAR high is that the supervisory boards in many countries where microfinance is prevalent are not very experienced and have limited tools.

These are all good reasons, yet Peru and Bolivia both have lowered their capital requirements for MFIs. Although the microfinance requirements remain much higher than the 10 percent required for banks in these countries, the reduced levels have helped spread the breadth of microfinance in these countries. These lowered requirements have not had disastrous effects on the countries; rather, the MFIs tend to hold more capital than is legally required (The Economist Intelligence Unit). Currently in Colombia, regulated MFIs are put under the same stipulation as all banks, which have a CAR minimum of 9 percent, but by lowering this required ratio for MFIs, more may be willing to become regulated and offer deposits to poor civilians (The Economist Intelligence Unit). Because each country is unique, the CAR should be a relative figure. CAP guidelines have the CAR

much higher than banks but best practices for these banks would have these rates lower for banks; MFI CAR rates should have the same minimum as banks, which would allow an MFI to determine its own CAR level.

Many regulators impose an unsecured lending limit on banks; however, because the portfolios of MFIs are composed primarily of unsecured loans, this limit should be relaxed for regulated MFIs. Studies have shown that these unsecured portfolios perform well when the financial system is running well, so this restriction should be waived for MFIs that would be crippled by such a requirement. Additionally, loan-loss provision should be treated differently for microloans versus regular loans. Loan-loss provision should not be taken into effect until after there is a delinquent loan, and this should be treated more aggressively than if the loan is secured (Christen et al.). In Peru, provisioning begins on a microloan after payment is a week overdue and grows to 100 percent after 120 days (Vogel, p. 12). Because Peru has found success with this policy in its practice as MFIs have become more sustainable and market penetration has expanded, Colombia should consider instigating a similar process.

Nonprudential Regulation

Nonprudential regulation is mainly for the benefit of the customers. This type of regulation requires a level of transparency by the deposit-holding institution and serves to protect the consumer against confusing fees. Nonprudential regulations also call for clearly audited financial statements so the institution can be monitored easily. Best practices suggest that nonprudential regulations are needed for all MFIs, including MFIs that do not hold deposits. This helps prevent uneducated clientele from being taken advantage of through the use of confusing terminology; transparency is necessary so that borrowers know all the details behind their loans (Vogel, p. 5).

Comparing Regulatory Environments

Peru is viewed as the highest-ranking country for its regulatory environment for microfinance (The Economist Intelligence Unit). Peruvian microloans, loans without collateral, are defined by the upper limit of U.S. $7,000. Regulations for microfinance focus on capital requirements and an assessment of a client's risk profile. A client's risk profile is determined by borrowing history recorded in credit bureaus, past borrowing with the MFI in question, and ability to repay the loan as determined by cash flow. The flexibility that the Peruvian regulatory framework has shown over time adapting to changes in knowledge about the relatively new industry has paved the path for the continual growth of the microfinance industry in this country. Of the 19 largest MFIs in Peru, only one is not regulated and cannot hold deposits. Supervisory practices are focused on internal controls and constantly remove rules that may hinder flexibility and proficiency. The focus of regulations on making it easier for MFIs to operate has led to a self-sufficiency of the microfinance industry in Peru, funded largely by depositors. Fostered by this relaxed regulatory environment, market penetration has increased through the growth in borrowers, interest rates have fallen through increased competition, and deposits have increased (Vogel, p. 10).

Bolivia is the second-highest ranking regulatory environment for microfinance worldwide, behind Peru (The Economist Intelligence Unit). There are many similarities between the regulatory environments of these two countries, including malleability in allowing a diversity of entities to issue microfinance services and increased standards for accounting that are in place to protect clients.

Colombia should reference and model the adaptable regulatory regimes put in place in Peru and Bolivia. Using similar practices, such as reducing CAR requirements and using a unique regulatory framework specific to microfinance, will help more entities offer deposit-holding services to poor Colombians who are looking to save. At the same time, as in Peru, increased market penetration and competition may help decrease interest rates and foster growth in both borrowers and depositors in Colombia.

Interest Rates

The interest rate ceiling in Colombia is the biggest deterrent keeping MFIs from

becoming regulated institutions. As discussed previously, WWB explicitly stated that the interest rate cap is their biggest drawback from becoming a regulated MFI. In a positive move along these lines, Colombian law has raised the ceiling in 2011 from 39.89 percent to 50.2 percent (Castellanos). Nevertheless, the expenses of the highest cost loans remain too high for MFIs to cover with this still restrictive rate, which results in fewer loans. The poorest of the poor are hit the hardest by the restrictions on interest rates. With loans that are extremely small, a higher interest rate is necessary in order to cover the costs of providing a loan. Although regulators have raised this ceiling, it is still an unnecessary restraint. MFIs are hesitant to become regulated entities with the power at the hands of the government to reduce the interest rate cap in the future.

To make up for costs not covered by interest, many MFIs in Colombia charge fees, such as required insurance or BCSC's moratorium fees for late payments (Banco Caja Social). These fees decrease transparency for borrowers by making it difficult to compare loan products between MFIs. Not only does the lack of transparency make it difficult for consumers, most of whom are illiterate, but also it discourages competitors from entering the industry because they cannot make sense of the real costs (Robinson). NGOs choose to remain unregulated in order to avoid the strict interest rate restrictions.

Both Peru and Bolivia have removed interest rate controls on all financial institutions, allowing MFIs to be less fearful of becoming regulated entities (Vogel). By nature, MFIs need to offer higher interest rates on their loans because of their small size, high transaction costs, and high risk. Many consider the high interest rates as taking advantage of the poor; however, as discussed previously, the alternative means of financing available to the poor is from moneylenders in the informal sector who offer much higher interest rates (Rutherford and Sukhwinder). It would be in the best interest of the microfinance industry for the Colombian government to abolish the interest rate caps put in place on financial institutions so that more MFIs are encouraged to become regulated institutions that may hold deposits.

Credit Bureaus

Credit bureaus are helpful in determining the likelihood of a client of paying back a loan. MFIs can assess cash flows and the character of the borrower via a credit history. This is especially important in the microfinance industry where there is a lack of collateral to back the loans. The use of credit bureaus in Bolivia has enabled a recovery in the microfinance industry after an over-indebtedness problem—the credit bureaus were able to track the borrowings of clients across the country. The number of nonregulated MFIs that have opted to participate in credit bureaus has increased since the crisis and the industry since has been stable. Similarly, Nicaragua had a crisis related to an over-indebtedness problem: in 2009, 40 percent of active borrowers had outstanding loans from more than one MFI (Chen et al., p. 7). Credit bureaus are critical for enabling information sharing to help MFIs restrict multiple borrowing among clients. Colombia, with an abundance of nonregulated MFIs not required to report, is more susceptible to experiencing an over-indebtedness problem for its poor because there is no way to determine the number of loans people take out from various nonregulated MFIs (Vogel, p. 20).

One innovative practice currently used in Colombia by the Inter-American Development Bank is the bank's partnership with Medellin's utility company, Empresas Públicas de Medellín (EPM), to develop credit histories for poor utility users. EPM created the Financiacion Social program, which provides affordable credit lines for the poor to purchase appliances and information technology products. EPM is able to adjust rates for customers with whom they have a long relationship of issuing credit. Repayment of these loans is reported to one of Colombia's credit bureaus helping consumers develop credit histories, which may help them obtain more financing in the future (Inter-American Development Bank).

Innovative practices like these are advisable in the nonregulated sector, especially for lenders who may wish to become regulated institutions in the future. The benefit of credit bureaus for regulated institutions reflects both on the consumer and the MFI itself. This additional guidance will keep borrowers from

taking on more debt than they can handle. On the MFIs' side, being better able to assess the level of risk for each consumer will help them reduce interest rates for borrowers who have a history of good credit, even if this history is not with the lender itself. This is particularly helpful for borrowers who relocate within Colombia so they do not need to start fresh at each MFI.

Public Banks

Abolition of subsidized public banks that provide below market rate services is also necessary for the microfinance industry to boom in Colombia. Public banks are notoriously inefficient, make it challenging for new entrants to compete, and they often incur losses the government later needs to restore. The public banking system is corrupt in that these banks provide subsidized loans to preferred clients—often powerful groups in government and politics. For instance, Colombia has the third highest percentage of loans from public banks going toward the public sector with 23.06 percent (Micco and Panizza, p. 39). The return on assets (ROA) in these banks is lower than in private banks; Micco and Panizza's performance indicators have Colombia's ROA at –.0098, ranked the second lowest in Latin America. This may be an indicator that these banks are lending to preferred clients on unprofitable projects. Additionally, people choose to put their money in public banks with the belief that the government backs their deposits. This deters development of competitors by turning depositors away from commercial banks. State ownership of banks in Colombia was 57 percent in 1970 and 75 percent in 1985 and then declined to 53 percent in 1995, while in Bolivia, the share went from 53 percent to 69 percent and down to 18 percent in those same years. Bolivia has since completely eliminated the public banking sector while Colombia continues to use public banks. Likewise, Peru has removed subsidies for banks, essentially eliminating the public banking sector (Micco and Panizza). Where public banks are available, the private sector is reluctant to compete with the subsidies and regulatory favoritism. It has been shown that many people view loans from public banks as charity, and because of this they do not pay back their loans. The inefficient public banks in Colombia should be eliminated, helping to pave the way for the microfinance industry to blossom in Colombia.

Colombia's state bank, Banagrario, holds 26 percent of Colombia's microcredit portfolio but is considered an MFI and is not covered by MixMarket. This state-run agricultural development bank finances mainly rural, agricultural, livestock, fishing, forestry, and agro-industrial sectors (Banco Agrario de Colombia). Banagrario is a dominant competitor with the MFIs operating in Colombia. To compare market shares, the NGOs, FMM Popaján and WBB, have 14.1 percent and 8.9 percent, respectively, and the bank Bancamía has 18.6 percent market shares (MixMarket). With such a large, government-supported bank competing in the microfinance market, it is incredibly difficult for MFIs to serve clients who work in the agricultural market.

Conclusion

The comparatively hostile regulatory environment in Colombia causes many MFIs to be apprehensive about becoming regulated institutions. Unregulated MFIs are limited in the services they can offer clients and are often dependent on donor funds. Yet, savings and deposit-holding services have proved to be some of the most desired services for the unbanked. Additionally, donor independence has proved, in various studies, to help MFIs grow and cover more of the potential market. Colombia has the potential to have one of the largest microfinance industries in the world, but the regulatory environment is crippling the country's ability to capture the market and provide much-needed banking services to the poor. Adapting the regulatory system in Colombia is key for the country to reach the levels of market penetration seen in its neighboring countries, Peru and Bolivia.

In order for MFIs to offer deposit and other services to clients, they must have both prudential and nonprudential regulatory practices. Modeling prudential regulation after Peru and Bolivia, Colombia should consider relaxing capital requirements for MFIs. Similarly, best practice nonprudential regulations suggest abolishing the interest rate ceiling in Colombia. With

the interest rate ceiling, many MFIs use fees to cover the costs of lending small loans or simply do not offer extremely small loans for which they are not able to cover the cost. This eliminates many of the poor from acquiring financial services, opposing microfinance's goal of full financial inclusion. Public banks, notoriously inefficient and often viewed as charity, use subsidies and perceptions of government guarantees to lure clients away from the microfinance industry.

Additionally, access to credit histories of borrowers through credit bureaus would help keep borrowers from becoming over-indebted as well as help them build a widely used credit history. The goal of microfinance is to provide financial services to the world's poor, and, by strengthening information sharing and transparency, while relaxing other elements of the regulatory environment in Colombia, MFIs would be able to offer more services to those in need.

Colombia has begun working on developing a new regulatory framework regarding microfinancial activity of regulated entities. Hopefully, this new framework, by following best practices and abolishing restricting laws, will give the microfinance industry in Colombia a better chance to grow. Already several influential players have become regulated and, as time progresses, many others may join. The 26 members of the national association of Colombian MFIs, Asomicrofinanzas, account for 90 percent of the market. They build platforms to collect, manage, and disseminate information about the market and have started working with the government's Superintendencia Financiera to compose this new regulatory regime. These positive steps toward providing a unique framework for regulating MFIs in the country will help pave the way for the microfinancial industry to expand its horizons and spread much-needed access to financial services to Colombia's poor.

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