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APEX ORGANIZATIONS
AND THE GROWTH OF MICROFINANCE IN BOLIVIA

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Table of Contents

List of Acronyms

BancoSol	*Banco Solidario S.A.*
BCB	*Banco Central de Bolivia*
CAF	*Corporación Andina de Fomento*
CRD	*Corporaciones Regionales de Desarrollo*
FIE	*Centro de Fomento de Iniciativas Económicas*
FDC	*Fondo de Desarrollo Campesino*
FFP	*Fondo financiero privado*
FND	*Financiera de Desarrollo Santa Cruz S.A.M.*
FDR	*Fondo Nacional de Desarrollo Regional*
FM	*Fondo de Microcrédito*
FOCAS	*Formación de Capital en Areas Secundarias*
FONDESIF	*Fondo de Desarrollo al Sistema Financiero y Apoyo al Sector Productivo*
FONVIS	*Fondo Nacional de Vivienda Social*
IBEE	*Instituto Boliviano de Estudios Empresariales*
IDB	Inter-American Development Bank
KfW	*Kreditanstalt für Wiederaufbau*
MFO	Microfinance organization
NAFIBO	*Nacional Financiera Boliviana S.A.M.*
NGO	Non-government organization
NPC_I	Net present cost to an investor
NPW	Net present worth
PAM	*Programa de Apoyo a la Microfinanza*
PMP	*Programa de Microcrédito Popular*
PRODEM	*Fundación para la Promoción y el Desarrollo de la Microempresa*
SBIF	*Superintendencia de Bancos e Instituciones Financieras*
SDI	Subsidy Dependence Index
USAID	United States Agency for International Development

Apex Organizations and the Growth of Microfinance in Bolivia[1]

Sergio Navajas and Mark Schreiner[2]

I. Introduction

Microfinance is access to financial services by poor households. In the mid-1980s, donors and governments realized that efficient public interventions in microfinance might help to improve social welfare. This could happen as long as market failure prevented the legitimate demand of poor households from being matched by a private supply of financial services.

For example, perhaps private banks did not explore microfinance because of market failure in the research and development of profitable financial technologies or because of market failure in the supply of information about the risk of lending to poor households. Market failure emerges in these circumstances because private investors cannot capture all the returns from their research and development efforts. Instead, the knowledge and information that they produce soon become a public good, available at minimum cost to the competition.

Constraints on interest rates and rigid regulation, coupled with vestigial habits and culture, may also have helped to keep private banks out of microfinance. As new lending technologies become widely available, however, commercial banks may increase their interest in microfinance.

In Bolivia, the first attempts to mitigate possible market failure in microfinance with government-owned development finance institutions failed. This, along with the growth of distrust in direct government intervention, made room for a second round of non-government interventions (Monje, 1995). Non-government organizations (NGOs) began to provide financial services to poor households. These financial NGOs are microfinance organizations (MFOs).

Compared with MFOs worldwide, MFOs in Bolivia have had uncommon success (Gonzalez-Vega *et al*., 1997). Bolivia has, for example, the first financial NGO (PRODEM) to grow to become a chartered bank and to take many small deposits (BancoSol). Bolivia also has some of the few

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MFOs that use individual loans to reach people almost as poor as those reached by group loans (Caja Los Andes and FIE). Bolivia is also the site of important experiments in small loans with terms adjusted to match the cash flows of farms and rural households (PRODEM and Caja Los Andes). In terms of outreach, financial performance, cost-effectiveness, and sustainability, the best MFOs in Bolivia are also among the best in the world.

All MFOs in Bolivia have received some support from donors and government, which have channeled some of this support through apex organizations. Alternative mechanisms to deliver this support, which have relied on the operations of a domestic apex organization, have been, nevertheless, even more important. The present case study, however, examines only the role of apex mechanisms in the development of microfinance in Bolivia.

An apex organization links retailing MFOs with donors and government. An apex receives resources from government and donors, transforms the resources in some way, and then supplies the new form of support to retailing MFOs which deal with individual clients. Thus, an apex organization can serve two functions. First, an apex might be a financial intermediary between government, donors, and MFOs. Second, an apex might help to create or to develop a microfinance sector (Gonzalez-Vega, 1998a).

In theory, the apex organization is meant to perform the same functions as a donor but without the same constraints and at less cost. For example, a donor might lend just large sums of cash which an apex breaks into small sums lent to many small MFOs. Or an apex might transform the cash into other forms of support that it might produce better than the donor or that might address more important constraints than a cash gift would. The apex organization might also produce public goods for the microfinance sector.

In principle, this division of labor between donors and an apex could make sense if donors cannot or will not provide support efficiently in the levels and forms that would relax the most important constraints faced by the microfinance sector. For example, retailing MFOs may need technical assistance to strengthen their sustainability, but donors may be constrained to provide just cash. The apex might transform cash from the donor into technical assistance. Or an apex with a fixed budget rule may provide better incentives to retailing MFOs than donors can since donors, without a fixed budget rule, have few reasons to demand disciplined, sustainable performance from MFOs. In short, an apex could lengthen the horizon through which a donor demands performance from an MFO.

Caution must be exercised, however, in using apex organizations for these purposes. A domestic apex may not necessarily be the best mechanism to transform donor resources into the promotion of sustainable NGOs. Moreover, domestic apex organizations owned by governments or with similarly weak property rights structures may not have a fixed budget rule or may be forced to respond to the vested interests of principals (maybe its clients) without the discipline that results from a fixed budget rule. In some other cases, the domestic market of MFOs may be too small for these transformations to be cost-effective (Gonzalez-Vega, 1998a). This case study addresses these issues and challenges from the perspective of Bolivia.

The objectives of this case study, especially as regards to Funda-Pro, the main microfinance apex in Bolivia, are:

(a) to determine whether apex organizations in Bolivia, by their financial intermediation, have relaxed constraints on funds for MFOs;
(b) to determine whether apex organizations, through development of the microfinance market, have improved the sustainability of MFOs;
(c) to isolate the main reasons why apex organizations have failed or succeeded to support the growth of the microfinance sector in ways that improve welfare for the poor so as to draw lessons from the Bolivian experience for the design of apex organizations; and
(d) to identify future constraints and possibilities for apex organizations in Bolivia.

The main results of this case study are the following:

Apex organizations in Bolivia have provided quick and timely loans to MFOs in need of liquidity. On a whole, however, apex organizations have not relaxed important constraints on funds for MFOs. They have not intermediated funds much.

Apex organizations have not improved the sustainability of MFOs in Bolivia much. The strong MFOs now in place developed without the help of an apex. Thus, apex organizations have not developed a market. Indeed, an apex that intermediated funds might destroy its ability to develop a market since MFOs would have fewer reasons to strengthen their sustainability through the pursuit of funds on the market (deposits and loans from commercial sources).

Apex organizations in Bolivia have failed for at least five reasons:

First, the apex organizations were not designed with the strength of the microfinance sector nor the welfare of the poor in mind. Some were not designed at all.

Second, the apex organizations serve the needs of donors or government rather than of the microfinance market. The best way to strengthen microfinance so as to help the poor came just as an afterthought.

Third, Bolivia is a small country with few MFOs. Apex organizations have limited scope to lower costs through economies of scale.

Fourth, squabbles among donors and within government have led to high start-up costs in terms of time and effort which have not been recouped since several apex organizations have been aborted.

Fifth, the signal of strength implicit in supervision by a regulatory authority has been perverted. Supervision, meant to protect depositors, now enables an MFO to get access to cheap apex funds and thus skip work to attract deposits or other funds from the market.

The main government apex (NAFIBO) has its work cut out for it. While it is somewhat shielded from pressure to disburse by the rule that it lends just to supervised financial intermediaries, this rule has just shifted the pressure to the supervisory authority to regulate more and weaker entities. This government apex will lend funds but, as more and weaker MFOs become supervised and do not repay, the apex will slowly shrink unless propped up with fiscal injections. It will intermediate some funds, but it will not develop the market, and it may well undermine sustainability since it destroys incentives to pursue market funds. A proposed government apex to help create a market (PAM) suffers from lack of expertise and serious shortcomings in its organizations design.

In contrast, the non-government apex in Bolivia (Funda-Pro) may be sustainable, since it cannot rely on more and more funds from donors. This instills some discipline, and this apex organization may well intermediate funds for the best MFOs for a long time as long as the competition with the government apex organizations does not drive it out of the market. At the same time, the non-government apex has few incentives to develop the market, and it has limited ability to provide the type of technical assistance that leads to sustainability for its MFO partners.

A transitory apex might play a short-term role in Bolivia if it could strengthen MFOs in rural and urban areas in technology to take deposits and if it could foment experiments in lending technology among rural MFOs. The current apex organizations are not set up to do this, and it would not make sense to create yet a third apex in the pursuit of such a small, uncertain outcome. Moreover, the lack of sustainability of the transitory apex may reduce incentives for efficient performance.

II. Microfinance in Bolivia

An apex organization needs MFOs as its customers. In turn, MFOs need household-enterprises as their customers. How an apex succeeds or fails to foster the growth of a strong microfinance sector depends on the comparative advantages of an apex to relax the specific constraints faced by the MFOs it serves. In turn, the constraints faced by MFOs depend on the nature of the demand of their customers, on their financial technology, and on the organizational structure needed to produce financial services in the long term without continued public support. The experience in Bolivia also shows that how one apex performs depends on how it can compete with other apex organizations that could perform the same functions.

A. The microfinance sector in Bolivia

1. Demand for microfinance

Bolivia is the poorest country in South America. The gross domestic product per capita is about US$800 (World Bank, 1997). About 70 percent of its 7.4 million people live below the poverty line defined as satisfaction of some basic needs (Ministerio de Desarrollo Humano, 1995). Income is low, but economic growth has been steady for the past decade. About 2.5 million people are economically active, and about 1 million are self-employed or work in family enterprises (census data for 1992 cited by Müller y Asociados, 1994).

It is difficult to know what the *legitimate* demand for microfinance might be in an undeveloped or non-existent market. There is an identification problem: the observed volume of transactions might be low because demand is low, but the observed volume might also be low because supply is low. The high interest rates observed and an understanding of the challenges faced by lenders suggest that a limited supply is the most important reason for a shallow market.

Households with *legitimate* demand can pay the costs associated with an efficient, sustainable supply. Not all household-enterprises have a legitimate demand for credit (Gonzalez-Vega, 1997a). At least some households who claim to demand loans would, in fact, default if they got a loan. Moreover, the costs of a sustainable supply of microfinance are not known, and at least some households who claim to demand loans would not want to pay the price of a sustainable supply. The costs of a sustainable supply are not written in stone, but they may not decrease with time if there is market failure in the research and development of better financial technologies.

With these caveats in mind, clearly Bolivia has many poor households who might demand microfinance. For example, the dominance of small-scale farms in the Andean plateau and in the Andean valleys has meant that many rural people are self-employed on farms. Furthermore, in the 1980s the collapse of the mines as a source of employment forced many households to turn to microenterprises to earn a living. Finally, the flood of cheap imports used to launder dollars has created a big sector in petty trade, and traders on the street corners of urban Bolivia sell anything from boxed breakfast cereal to microwave ovens.

Rosenberg (1994) states that most estimates of the amount of funds that would sate the demand for microloans in Bolivia cluster at US$300 million. Larrazábal (1997) estimates that the number of informal urban microenterprises is about 500,000. This is neither an upper bound nor a lower bound on the number of potential customers of MFOs.

Half-a-million microenterprises are not an upper bound on the number of potential clients of MFOs since households not linked with a microenterprise may demand microfinance as deposits, payments services, or consumer loans. The figure also excludes rural microenterprises and small farms. Half-a-million is not a lower bound either. It ignores the fact that not all microenterprises want loans at all times. For example, some people run microenterprises just until they can find wage employment. Furthermore, not all microenterprises are creditworthy, and other microenterprises may accumulate sufficient working capital to be able to rely on self-financing most of the time. Still, 500,000 may be a useful first guess for the number of creditworthy households in all of Bolivia that might at some time have a legitimate demand for some type of microfinance.

At the end of 1995, rural and urban MFOs in Bolivia had about 200,000 active loan clients with an outstanding balance of about US$77 million (See Table 1 below). The two largest urban MFOs, BancoSol and Caja Los Andes, accounted for more than one-third of the clients and for more than half the portfolio outstanding (Gonzalez-Vega *et al.*, 1996). Since these MFOs are among the best in the world, the fact that most of their customers are above the poverty line as measured by an index of basic needs suggests that many poor households may not have a legitimate demand for microloans (Navajas, *et al*., 1997). This may also suggest that a cost-effective lending technology to reach very poor people may not yet have been developed.

Thus, about 300,000 households might have a legitimate, unmet demand for microfinance. These households likely are poorer than the 200,000 households that already use microfinance. In most cases, any unmet demand is likely more for deposits than for loans. In fact, many households who might demand deposits may not be creditworthy.

The urban microloan market for MFOs may be close to saturation. MFOs in large urban areas such as La Paz-El Alto and Santa Cruz compete with each other more and more, new branches grow more and more slowly, and much of the growth of urban MFOs has come from expansion into smaller urban centers (Gonzalez-Vega *et al*., 1997).

In contrast to the shrinkage of virgin frontier for microfinance in urban areas, rural areas may be ripe for expansion. Cutthroat competition is absent in niche markets spawned by sparse populations in varied, distant, and isolated places. Most rural MFOs are small, however, and very small size and high income covariance may present significant obstacles to the expansion of microfinance in small rural market niches (Gonzalez-Vega, 1997b).

Thus, not only do rural areas contain the most unmet demand by customers of MFOs, but rural MFOs are weaker than urban MFOs. Rural MFOs may thus have more to gain from the services of an apex organization, not in terms of funds, but in terms of support services to strengthen sustainability and organizational capacity.

The microdeposit market for MFOs is wide open in all areas. BancoSol is the only MFO that offers deposit services on a large scale in rural or in urban areas. Caja Los Andes has only recently begun to offer deposit services. An MFO that took deposits would compete in urban areas with BancoSol and Caja Los Andes and with commercial banks.

In sum, there may be some room for MFOs to lend more in rural areas and to take deposits in all areas. Deposit mobilization, however, is a difficult task (Schmidt and Zeitinger, 1996). This may offer opportunities for an existing apex organization, building on start-up costs that are already sunk, to find a new role. This would require a rigorous appraisal. The opportunity however, is not sufficient reason to create new apex organizations.

2. Supply of microfinance

Compared to most other low-income countries and compared to the size of demand for microfinance, Bolivia has a huge supply of microfinance. A lot of this is due to the success of PRODEM-BancoSol, FIE and Caja Los Andes. These MFOs did much of the research needed to develop a technology tailored to Bolivia. Other MFOs have learned by watching them and by hiring away their experienced personnel.

Bolivia has many NGOs and has received a lot of external development assistance, in part because it is poor and in part because it produces a lot of coca for cocaine. In addition, Bolivia has few people for its physical size. The rural distances and the rugged topography have created many niches for financial NGOs. Long distances and low density of population, however, sharply increase transaction costs and constrain the expansion of microfinance.

Financial organizations in Bolivia can be split into two groups: supervised and unsupervised. The Superintendency of Banks and Financial Institutions (SBIF, *Superintendencia de Bancos e Instituciones Financieras*) is the government office in charge of prudential supervision. It share regulatory authority with the Central Bank of Bolivia (BCB).

a. Supervised financial organizations

The SBIF supervises commercial banks, private financial funds (FFPs, *fondos financieros privados*), savings and loan associations (*mutuales para la vivienda)*, and some credit unions and open cooperatives (*cooperativas abiertas*). FFPs are non-bank financial intermediaries that can take deposits but that cannot offer all the services offered by a bank. Open cooperatives can deal with non-members, while close cooperatives cannot. To mobilize deposits from non-members, open cooperatives must comply with certain equity and accounting standards.

i. Growth of supervised financial organizations

Since the end of 1986, the size of the supervised financial sector has grown at an annual rate of almost 20 percent. The aggregate loan portfolio of the commercial banks went from US$500 million in 1986 to US$1.2 billion in 1990 to US$3.7 billion in 1997 (BCB, 1990; SBIF, 1997). The number of supervised entities skyrocketed along with the size of the sector. In 1990, the SBIF supervised 20 banks. By 1997, the SBIF supervised 54 financial organizations: 17 banks, 18 cooperatives, 13 savings and loan associations, 4 FFPs, and 8 organizations offering specialized financial services.

The success of Bolivian MFOs has been in step with the development of its whole financial sector. This leads to two observations. First, strong Bolivian MFOs have flourished in a friendly environment, but no one knows if they would have floundered in a hostile environment. Their performance may or may not be robust to the external conditions of the domestic economy. In particular, their ability to absorb major systemic exogenous shocks hay yet to be demonstrated. Second, banking in Bolivia has expanded without even a nod toward the microfinance sector by private commercial banks. This could easily be due to the wealth of unexploited opportunities among richer households and firms, or it could be due to the costliness of providing financial services for poor households by banks even in the best of times. As the frontier of more traditional clienteles is exhausted and as new lending technologies become widely available, commercial banks may make incursions in microfinance market niches.

ii. What supervision means

Supervision matters for MFOs and for apex organizations in Bolivia since the law restricts the main government apex (NAFIBO) to work just with supervised financial intermediaries. This restriction provides a potent tool for an apex that wants to intermediate funds and to develop markets. For the apex, the constraint allows it to lend just to the best MFOs. This helps repayment and thus the sustainability of the apex. For the MFO, the constraint creates a reward for those MFOs that work to strengthen themselves enough to qualify for a license (charter) from the SBIF.

The constraint thus helps to strengthen the market for microloans. It also serves, however, to wither the market for microdeposits. A supervised MFO should be more likely to raise funds from the market on its own. Such an MFO that qualifies for supervision likely has resolved already most of the problems of organization and capacity that plague smaller, weaker MFOs. The link between supervision and access to the government apex removes, however, much of the incentive to actually get funds from the market as deposits from the public. The apex gives supervised MFOs—exactly those MFOs that can take deposits—a new source of large amounts of cheap, long-term funds. This access to cheap funds decreases the incentives to mobilize deposits. This matters in Bolivia since the greatest unmet demand is not for microloans but for microdeposits.

Bolivian MFOs are in a stampede to the door of the SBIF with a wish to become supervised. Not all the MFOs that want to be supervised plan to take any or many retail deposits. In fact, some

MFOs may see supervision less as a way to capture funds from depositors in the market and more as a way to gain access to funds from government and donors funneled through the apex. The irony is that while supervision enables an organization to take deposits and can be seen as a signal of strength, and while the microfinance service with the largest unmet demand is deposits, the link between supervision and open access to cheap funds from an apex may relieve an MFO from the need to push itself to make the effort to vigorously attract deposits in the market.

The reliance on certification of an MFO by the SBIF means that the government apex has in part abdicated its role as monitor and evaluator of MFOs. The apex has surrendered its possibility to add value as a local source of knowledge learned about the creditworthiness and sustainability of MFOs. This screening function has shifted, and now it mostly rests with the SBIF. The apex does do not much, except perhaps to separate the supply of funds from the supply of knowledge about creditworthiness.

As of August 1997, the supervised MFOs and other supervised non-bank organizations fell essentially under the same regulatory framework as the commercial banks, and there were not yet rules fitted to their unique features in all cases. There were but two supervised MFOs: BancoSol, a commercial bank, and Caja Los Andes, an FFP. Another FFP, FIE, became a supervised MFO in early 1998.

b. Unsupervised financial organizations

Unsupervised financial organizations include more than 200 cooperatives and about 33 financial NGOs. Their financial transactions are small. These MFOs show an average loan disbursement of about US$400. In contrast, 85 percent of the loans from commercial banks exceed US$20,000 (Table 1).

An apex that wanted to further develop the microfinance market would focus on these unsupervised financial organizations. The supervised organizations do not need non-financial help from the apex since they are already developed. All the apex can do is to help them with their funds constraint, if they have one. There might be scope, however, to help develop the organizational capacity and sustainability of the smaller, weaker, unsupervised MFOs. Not funds but technical assistance are needed in this case. This is a more difficult task, and apex organization possess limited comparative advantages in this area.

This technical assistance is not mere gifts of canned how-to manuals. Rather, it is a long-term, one-on-one presence within the MFO itself by a team of technicians from the apex. The apex technicians cannot dictate a financial technology, but they can inculcate the principles of the fundamental problems that a financial technology must resolve. They can implement specific improvements in areas common to all organizations and that are likely to become stretched and strained in an MFO that grows fast. Examples of these aspects are:

(a) design of a governance structure;
(b) guidance and urging to do strategic planning;
(c) design of systems for internal control;
(d) installation and customization of hardware and software to track transactions and to manage accounts;
(e) design of systems of incentives for personnel; and
(f) representation and handling of donors and their representatives.

Table 1: Output of commercial banks and MFOs in Bolivia, 1990 and 1995.

	1990			1995		
	Number of borrowers	Portfolio (millions of US$ as of Dec. 31)	Average loan size (US$)	Number of borrowers	Portfolio (millions of US$ as of Dec. 31)	Average loan size (US$)
Commercial banks	94,716	1,245	13,146	126,912	3,512	27,670
All MFOs	N/A	6	N/A	208,174	77	370
BancoSol/Prodem	15,735	2.8	155	81,347	43	530
Caja Los Andes	0	0	0	15,954	6	381
NGOs	N/A	3	N/A	110,873	33	265

Note: BancoSol is not included in the figures for commercial banks.
N/A= Not available
Source: Casanovas and MacLean, 1994; CIPAME (1997), Gonzalez-Vega *et al*. (1997), and SBIF (1997).

B. Country strategy for microfinance

For the most part, the growth of the microfinance sector in Bolivia has come from upscaling MFOs that were NGOs into bigger and stronger organizations. In fact, Bolivia has the most famous upscaling project in the world, the budding of the commercial bank BancoSol from the NGO PRODEM (Katsuma, 1997; Mosley, 1996; Agafonoff, 1994; Glosser, 1994). Another example of successful upgrading was the transformation into FFPs of Caja Los Andes (Solares de Valenzuela, 1997) and FIE.

Some commercial banks and FFPs have expressed an interest in downscaling. Three examples of this extension are Banco Ecónomico, a commercial bank which has recently opened a window for microfinance operations (PRESTO), Financiera Acceso and Financiera FASSIL, two FFPs which have also begun to compete at the upper end of the microfinance market as its main line of business. Their market niches overlap with that of MFOs, in particular FIE and Caja Los Andes. The expectation is that these downscaling efforts will lead to an expansion of the share of regulated intermediaries in the microfinance market.

Downscaling commercial banks is probably the best way to improve access to microdeposits for poor households in Bolivia. Downscaling may not matter much for microloans since the credit market is almost saturated already. The dilemma is that downscaling for microdeposits cannot involve an apex in its role as a financial intermediary. Furthermore, an apex in its function as a market creator probably does not have the expertise nor the proven technology to help a commercial bank develop an effective deposit service useful to poor households.

C. The legal framework for microfinance organizations

The basic organizational forms for MFOs in Bolivia are NGOs, commercial banks, FFPs, and credit unions and cooperatives. These organizational forms differ in their property rights structures and in the regulatory framework that applies to them.

1. Microfinance organizations as NGOs

All current MFOs, whether supervised or not, were born as NGOs. These organizations were funded at least at first by donors, whether public or private, foreign or domestic. The number of financial NGOs in Bolivia mushroomed in the late 1980s and early 1990s. Financial NGOs are commonly called private institutions with social objectives (*Instituciones Privadas para el Desarrollo Social*). Financial NGOs do not fall under the banking legislation.

a. The growth of NGOs and financial NGOs in Bolivia

In their early years, most financial NGOs offered both microcredit and a gamut of non-financial services such as education, health services, or technical assistance with business or agriculture. Financial and non-financial services are strong complements for the households that consume them, and NGOs thought they could efficiently link them on the production side. In practice, the multiple purposes wrecked many NGOs. Non-financial services distracted NGO staff from financial services, and NGOs lost loads of funds to boot. This prompted some NGOs to focus just on microfinance (Marconi, 1996).

By 1995, Bolivia had more than 542 registered NGOs. About 33 were specialized in microcredit. About 90 percent of these 33 MFOs were founded after 1985, and about 45 percent were founded in 1990-92. About 8 percent were founded after 1992. Thus, most financial NGOs alive now were born in the late 1980s and survived a first round of consolidation. They did all of this without help from an apex.

b. The legal status of financial NGOs

The current legal status of financial NGOs is unclear. The 1993 New Law of Banks and Financial Entities and the 1995 Law of the Central Bank state that all financial organizations, including financial NGOs, must be supervised by the SBIF.

In addition, all NGOs that get funds from the government are supposed to be regulated by the government audit office (*Contraloría General de la Republica*). NGOs that do not get funds from the government nor from the public are excepted. The law counts all donations an NGO gets as part of a bilateral accord between a donor and the Government of Bolivia as funds from the government. Most estimates of the proportion of funds used by financial NGOs from these sources cluster at about 70 percent. Technically, this means that just about all financial NGOs should be audited by the government.

The laws that call for regulation of all financial NGOs that use government funds show that the government wants more control over the flood of donor money going to NGOs. This desire for a tighter rein on flows of aid was also part of the reason the government set up its own apex organizations. In general, as a country gets more and more funds for microfinance from donors, it gets more and more likely that the government will try to influence the use of these funds.

In practice, financial NGOs remain unregulated. The reason is that the SBIF is just too busy supervising other financial organizations. This is not necessarily bad. Financial NGOs might suffocate if held to the same reporting standards as commercial banks. In any case, financial NGOs do not take deposits from the public, so their supervision may not provide a public good in the same way as would the supervision of organizations that take deposits.

In the long term, the legal status of NGO may be just a larval stage. Most NGOs will die quickly. Those that live can do so only if they shed the congenitally weak governance and incentive structures of an NGO and take on a stronger, more sustainable form of organization.

The SBIF lacks a set of rules tailored to financial NGOs. But, again, this is not necessarily bad. A special charter or a special set of rules for financial NGOs may not lead to a stronger microfinance sector since:

(a) Special rules might decrease incentives for small NGOs to merge and acquire the size needed to apply for a more formal charter, such as an FFP. This might happen since a special charter for NGOs would likely require less equity than for a FFP. Fewer requirements (a lower bar) are always more attractive to the organization.

(b) Special rules might increase the costs of the SBIF, since many of the costs of supervision are fixed at the level of the organization. Supervising a gaggle of NGOs could also distract the SBIF from paying enough attention to the more important actors in the system. It may also be one step down a slippery slope in which the SBIF is saddled with more and more jobs unrelated to its role of protecting depositors and the basic safety and soundness of the financial system.

(c) Special rules might increase the opportunities for political intrusion in microfinance.

(d) Special rules might decrease the flexibility of NGOs to explore new financial technologies. This flexibility is one of the chief comparative advantages of an NGO (Schmidt and Zeitinger, 1996). Indeed, it is unlikely that the experimentation in lending technologies that underscores the development of microfinance in Bolivia would have been undertaken by commercial banks a decade ago. The catalysts for this experimentation were exceptional Bolivian individuals and their international contacts, not the efforts of any domestic apex.

2. Microfinance organizations as commercial banks

BancoSol is the only commercial bank that is also an MFO. The supervisory structure in Bolivia is well-developed and uncommonly competent, and BancoSol conforms to its standards in most ways just like all other commercial banks do (Rock, 1997; Krutzfeldt, 1997; and Trigo, 1996). There are no special rules for banks that provide microfinance, although BancoSol has asked for some small changes in how it is supervised.

The fact that BancoSol is subject to the same regulatory framework as if it were a traditional commercial bank limits the microfinance work of BancoSol in several ways:

(a) Banks cannot grant loans without a real asset as guarantee whose sum total exceeds the net worth of the bank. All of the loans of BancoSol lack a real asset as guarantee, and so BancoSol would need net worth equal to its portfolio if it were to comply with this rule. This would waste the chance to exploit leverage.

(b) Banks must make 100-percent provisions for loans greater than US$20,000 without real assets as guarantees. This limit could matter for BancoSol as its customers grow, especially since the loan is taken by the SBIF as the sum total of the amount outstanding to all members in a group, not the amounts outstanding for each individual member.

(c) For each loan, banks must provide detailed documentation for each borrower. In principle, this should include a risk analysis and a description of how the loan size and the guarantee relate to the financial data of the borrower. Unlike standard collateral-based lending, group lending does not use this information and thus its provision to the SBIF is not a sunk cost for BancoSol. Given that the average loan officer has a portfolio of more than 300 clients (Gonzalez-Vega *et al*., 1997), BancoSol could never hope to gather and manage all these data.

These rules reflect a regulatory framework that reduces the costs of the analysis of the risk of a portfolio with the proxy of the presence of real asset collateral as security for loans (Stiglitz, 1992). This design works well with large loan sizes and few clients, since the bank collects this information and does the required analysis anyway. MFOs, however, use a different technology to secure loans. They do not collect all this information as a matter of course, nor do they require tangible assets as guarantees. Thus, they appear to be very risky to a system geared for a technology based on tangible collateral (Gonzalez-Vega, 1997b).

In practice, the SBIF has been lenient with BancoSol because it understands the characteristics of its market. For example, an SBIF resolution exempted loans smaller than US$2,000 or smaller than 0.001 of the net worth of the bank from the sum total of loans without a real asset as guarantee that must be less than the net worth of the bank (Rock, 1997). Likewise, the SBIF has not insisted on detailed information on each individual borrower in the portfolio of BancoSol. The experience of the SBIF with BancoSol should help it when it forms the rules that will apply to FFPs, which currently follow the same rules as commercial banks.

Just like BancoSol, all banks pressure their regulators constantly to relax requirements and standards. The standards and requirements help to protect depositors and the general public from excessive risk-taking by banks when bank failures have important effects on agents outside the banks themselves. The challenge is to find a way to measure the risk in a portfolio of microloans in a way that is accurate and yet not too costly for the SBIF nor for the MFO.

Unlike the SBIF, an apex organization might have some incentive to act like a supervisor (monitor). An apex with a loan outstanding to an MFO has something to lose should the MFO go bankrupt. Thus the apex, perhaps more than a supervisor, has a reason to make sure the MFO acts with prudence and protects its financial viability, both in the short term and in the long term. An apex will act as a quasi-owner of its debtors and engage in sufficient monitoring as long as the apex itself cares for its own sustainability. This will happen only if the apex knows it has a limited budget both now and in the future and if maintenance of the budget depends on current performance.

There are mixed incentives when an apex tries to perform both of its main functions at once, lending funds and providing technical assistance. On the one hand, the funds may give the MFO a reason to submit to outside meddling through technical assistance. On the other hand, the implicit partnership created by the technical assistance may destroy the credibility of the threat of the apex to make the MFO repay. This would undermine repayment and thus harm the sustainability of both the MFO and the apex.

3. Microfinance organizations as FFPs

The 1993 New Law of Banks and Financial Entities included the possibility of the charter of FFP, although the charter did not exist until 1995. The FFP was the first attempt to recognize the uniqueness of financial NGOs. The main feature of the charter is to allow an entity with minimum capital of just US$1 million to be supervised and to be licensed to take deposits. In contrast, the minimum capital required of commercial banks is US$3 million. The FFP charter is not limited to MFOs. In fact, some commercial banks have used it to create finance companies to serve the market for consumer credit, a niche a notch or two above that served by MFOs.

Although FFPs need less capital than banks, FFPs face limits not faced by banks:

(a) No borrower or group of borrowers can get a loan backed by a real asset as guarantee larger than 3 percent of the net worth of the FFP.
(b) No borrower or group of borrowers can get a loan without a real asset as guarantee larger than 1 percent of the net worth of the FFP.
(c) No financial organization can have a credit relationship with the FFP in excess of 20 percent of its net worth.

Banks can offer some services that FFPs cannot:

(a) checking accounts,
(b) international trade transactions,
(c) trust operations and of charges of fiduciary duty, and
(d) credit cards.

Most customers of MFOs do not now have a legitimate demand for these services. In the future, however, checking accounts may be important microfinance products. They could also be an important source of low-cost funds for an MFO. Likewise, credit cards may turn out to be the cheapest way to make small loans, at least once the country has developed some and at least for households with wage income.

Caja Los Andes and FIE remain today as the only two NGOs to become FFPs. Still, it seems that most of the strongest, largest NGOs intend to make the switch to FFPs. In practice, this desire to switch seems to stem less from a desire to take deposits from the public and more from a desire to acquire the signal of strength implicit in supervision. In turn, supervision gives the MFO access to inter-bank loans and to the cheap, long-term funds in the government apex.

The creation of the charter of FFP shows the flexibility and willingness of the SBIF to adjust to support the growth of the microfinance sector. The charter was meant at first as a way to allow MFOs either to relax their constraints on funds, to provide deposit services useful to its customers, or both. The link between the status of FFP and access to the government apex serves the same function to relax constraints on funds, but it undermines the function of market development.

Funds from an apex, like funds from a donor, can distract an MFO from its work and encourage it to engage in costly acts not meant to attract clients on the market but to please the apex or donor. This harms sustainability. An MFO beholden to depositors not only improves welfare through the supply of the deposit service, but also becomes acutely aware of its financial responsibilities. This helps it to buckle down on loan repayment, incentive issues, and other factors that matter for sustainability (Poyo, Gonzalez-Vega, and Aguilera-Alfred, 1992).

D. Constraints on the sustainable growth of the microfinance sector

1. Deposit services in rural areas

NGOs that experiment with new lending technologies might generate have positive externalities since their research cuts the costs to make microloans for MFOs that enter the market later. NGOs do not take deposits, however, so they cannot experiment with microdeposit technology. Unless supervised MFOs think that deposits are the best way to relieve the pinch of a constraint on funds, they may not innovate in deposit technology. Thus, microfinance will not get closer to efficient, sustainable provision of deposits. This matters since, in Bolivia and elsewhere, deposits could very well have more potential than loans to improve the welfare of poor households and to spur development (Schreiner, Graham, and Miranda, 1998; Deaton, 1992; Vogel, 1984).

Urban households have more choices than rural households, especially for deposits (Bredenbeck, 1997; Wisniwski, 1995 and Olmos, 1997). Urban competition for deposits can be fierce. Unlike a loan, whose risk depends on the person of the borrower, a deposit is not subject to default risk by the depositor. A poor household that could never get a loan from a bank may still hold a deposit account with a bank. Even people who are not creditworthy may save and hold deposits.

Rural households in Bolivia have few choices for deposits. The credit unions in some small towns are unstable and are dominated by borrowers, thanks to foreign funds sluiced through their apex organizations. Credit unions have burned their depositors more than once in the recent past.

The financial organizations best equipped to take deposits are banks, but some banks have pulled out of smaller towns in Bolivia. The most widespread system of rural bank branches belonged to three public banks—Banco Agrícola de Bolivia, Banco del Estado, and Banco Minero—but they all closed in 1992-93. Banks cannot serve poor households in rural areas with deposit services cheaply since their branches have high fixed costs to spread over the meager savings of the sparse population. Poor households do save, but they hold small balances and make frequent deposits and withdrawals (Poyo, 1990). This increases the costs borne by the bank. A traditional bank branch with a traditional deposit technology may find the cost per dollar of deposits too high to make a rural location profitable.

In Bolivia as a whole, access to deposits has increased in the past decade. Hyperinflation slowed in 1985, and the economy started to shift from domination by the government to free-market principles. Funds from savings within Bolivia had been scarce, so the financial sector had relied on funds from external sources. After 1985, however, the balance began to creep away from external funds and back toward domestic funds. For example, time deposits from the public as a share of bank assets grew from about one-sixth in 1985 to about two-thirds by the end of 1996 (BCB, 1990; Muller y Asociados, 1996). But this has not much improved access to small, liquid, accessible, and remunerative deposit accounts for poor, rural households.

2. Lack of microfinance from commercial banks

Except for BancoSol, a commercial bank upgraded from an NGO, banks in Bolivia do not pursue microfinance much. This is especially true in rural areas. At the same time, the greatest growth potential for microfinance is among commercial banks (Boomgard *et al.*, 1992; Baydas *et al.*, 1997). Banks have the most potential since they have:

(a) widespread branch networks,
(b) a profit motive,
(c) private governance,
(d) competent organizations in place, and

(e) the licenses and the need to take deposits.

The most important blockages for commercial banks to work in microfinance are:

(a) the high risk and high cost of lending, and the high cost of taking small deposits, especially in rural areas;
(b) the inability to brand products so as to price microfinance services higher than traditional services in order to cover higher costs;
(c) the fear of competition from subsidized lenders; and
(d) high start-up costs due to the need for research and development when discoveries cannot be hidden from rivals.

3. Appropriate supervision

Probably the biggest unmet demand for microfinance in Bolivia is for deposits, especially in rural areas (Boomgard *et al.*, 1992). To take deposits requires prudential supervision, and the number of supervised financial organizations increased from 20 in 1990 to 53 in 1997. The capacity of the SBIF and the regulatory framework may not have grown in step. Much of the work of supervision is fixed regardless of the size of the supervised organization, and the SBIF has not trebled in size in the past seven years. In fact, the work required to judge the risk in the portfolio of an MFO may be greater, dollar-for-dollar, than the work required to judge the risk in the portfolio of a traditional bank. To supervise rural financial organizations costs still more.

The SBIF licenses and supervises non-banks, but it does not yet have supervisory guidelines for them. In some sense, the cart is before the horse. Rosenberg (1994) suggested that MFOs should strive to become supervised since licensed leverage could help to meet unmet demand. Rosenberg also stated that licensed leverage did not make sense unless the supervisory authority was prepared to do its job well and that the most pressing need for technical assistance was likely to be for the supervisory authority. Bolivia has lowered the standards for an MFO to become subject to supervision. Supervised MFOs can do much more than unsupervised MFOs, but it is not clear that the SBIF can track their safety and soundness as well as they should.

4. Technical assistance

Both Rosenberg (1994) and Boomgard *et al*. (1992) emphasize that the tightest constraint on microfinance in Bolivia is not funds but rather competent technical assistance to strengthen the capacity and sustainability of MFOs. Technical assistance matters more than funds both for NGOs that are upgrading and for banks that are downscaling.

Technical assistance may help address the three types of constraint. First, downscaling banks requires help in the development of loan and deposit services geared to poor households. Banks have strong organizations, but they do not know how to adjust their financial technologies, especially in rural areas. Rural deposits require some substitute for expensive brick-and-mortar branches, and urban and rural loans require some substitute for real assets as collateral.

Second, upgrading rural financial NGOs requires big technical changes. Both banks and financial NGOs must develop a sustainable product, but financial NGOs must also develop a sustainable organization. The switch from a social NGO to a businesslike MFO calls for change in both technology and psychology (Rosenberg, 1994). Most MFOs started life as socially-oriented NGOs. Compared to commercial banks and to the government, the advantage of financial NGOs is their vocation to serve the poor. Financial NGOs do not have, however, a built-in comparative advantage in technology, although their smallness and flexibility can allow them to develop one. The main stumbling block for financial NGOs is their lack of organizational design, their lack of owners, and their lack of leadership by experienced bankers. Thus, they often need to revamp their internal accounting, incentive systems, price structures, and overall philosophy.

Third, technical assistance may have a role to improve the supervision of MFOs. It may provide the supervisory authority with knowledge, based on experience worldwide, on the risk in a portfolio of microloans. Intense, long-term, on-site technical assistance for the MFOs may generate the information needed to prove to the supervisory authorities what an MFO can do.

Rosenberg (1994) believes that the shortage of technical assistance is due less to funds to buy technical assistance for MFOs and more to a shortage of qualified technicians. Donors may also have few selfish reasons to buy technical assistance for MFOs. Donors often have a short-term outlook, but good technical assistance requires a horizon of five years or more. Also, technical assistance cannot help donors to move huge sums.

5. Low population density

The heart of the problem with microfinance in rural areas is the sparse population. Bolivia has just 21 towns with populations in excess of 10,000 (Boomgard *et al*, 1992). It has just 35 towns with more than 8,000 people.

In many rural places, the fixed costs of banking, even when stripped to the bone, may be too high without the use of one-day-a-week mobile branches or some other such agile technology being explored by rural MFOs. In any case, the SBIF can authorize just full-time branches of a bank. This could turn out to be a severe constraint on microdeposits in rural areas.

Donors and government cannot change rural population density. Even if they could, there are much better reasons to do so than for its effect on microfinance. All donors and government may be able to do is to help to explore financial technologies that work with sparse populations.

III. Apex organizations in Bolivia

This section assesses the contribution of apex organizations to the growth of the microfinance sector in Bolivia in the past, present, and future. Apex organizations are divided in four groups.

The first group includes international organizations such as USAID, GTZ, or the IDB. These donors work with the government. They may also fund supervised or unsupervised MFOs directly or provide technical assistance. These donors support MFOs more and more, but microfinance is not their main job by any means. The role of donors in microfinance is not discussed here since it is discussed elsewhere. International NGOs such as ACCION International and private firms such as Internationale Projekt Consult (IPC) also share some of the functions of apex organizations. Although they have played a major role in the development of microfinance in Bolivia, they are not discussed here.

The second group includes apex organizations for credit unions. These apex organizations may work if they form after the development of a base of strong, deposit-based retailing credit unions. In this case, the apex intermediates funds between surplus and deficit credit unions and acts as a lender-of-last-resort. It may also function as a regulator and an auditor (Richardson, 1994; Richardson, Lennon, and Branch, 1993). An apex that serves as a funnel for donor funds, however, destroys the ground-floor credit unions. The flood of money discourages deposit mobilization and encourages rent-seeking by borrowers and managers (Braverman and Guasch, 1993 and 1986; Poyo, 1990). Apex organizations for credit unions also experience some of the shortcomings of organizational designs, proper of credit unions, of clients that are owners. These credit union federations are not discussed more here.

The third group includes government apex organizations. In the cases that matter for MFOs in Bolivia, these are offices spun off from the Central Bank or from some other now-defunct development bank. Their funds come from donors and from the fisc. The first three government apex organizations are the National Housing Fund (FONVIS, *Fondo Nacional de Vivienda Social*), the Development Finance Company of Santa Cruz (FND, *Financiera de Desarrollo Santa Cruz S.A.M.*), and the Regional Development Fund (FDR, *Fondo Nacional de Desarrollo Regional*). These three apex organizations are not discussed. The first is bankrupt, and the other two do not deal with MFOs.

The second three government apex organizations are the People's Microcredit Program (PMP, *Programa de Microcrédito Popular*), the Program of Support for Microfinance (PAM, *Programa de Apoyo a la Microfinanza*), and the Microcredit Fund (FM, *Fondo de Microcrédito*). PMP supported unsupervised MFOs, but it crashed quickly. PAM was also meant to support unsupervised MFOs, but it has yet to get off the ground. FM is a recent government initiative that is supposed to replace the PMP and PAM. The three of them, in different degree, have been supported by donors. They are discussed briefly below.

The last two government apex organizations—the Rural Development Fund (FDC, *Fondo de Desarrollo Campesino*) and the National Finance Company of Bolivia (NAFIBO, *Nacional Financiera Boliviana* S.A.M.)—do deal with MFOs. They are described in detail below. The key point is that FDC and NAFIBO deal just with supervised organizations. This limits them to the few MFOs that are already strong, and it has created a clamor for a way to get MFOs supervised.

The third group includes non-government apex organizations. Funda-Pro is the only one. Although Funda-Pro is non-government, all its funds came from donors and government. It is private only inasmuch as those public entities have relinquished their control over those funds and the organization. Funda-Pro wants to be supervised, but it lends to MFOs whether they are supervised or not. Funda-Pro has lent more to MFOs than any of the other apex organizations. It is the most important apex for MFOs in Bolivia. Still, it has had but a slight impact on the development of the microfinance sector of this country.

A. Programa de Microcrédito Popular; an aborted microfinance apex

PMP started in February 1995 with US$2 million from the Government of Switzerland. The purpose was to help to extend the outreach of MFOs to rural areas and to unattended urban areas. A board of trustees was charged with selecting NGOs and unsupervised cooperatives eligible to bid for donations. The bid consisted essentially of a proposal to start a branch in a place where the MFO did not yet have a branch, usually in a rural area. An MFO which won a bid would get an injection of equity with the condition that the equity, which need not be repaid to PMP, would become a liability that must be repaid in the case that the MFO did not use the funds as promised. The only financial cost to the MFO was a 2 percent flat fee on the amount of equity injected.

PMP held two bids in 1995, and it injected about US$1.5 million in four cooperatives and in six financial NGOs (FIE, Sartawi, ANED, FADES, IDEPRO, and Agrocapital). Since then, PMP has fallen into disuse as government and donors have looked for other ways to support MFOs. The disuse had at least two causes. The first and the chief problem was the make-up of the board that picked MFOs to bid. The board had representatives from donors, the Central Government, the Central Bank, from a network of urban MFOs, and from a network of rural MFOs.

In a way, NGOs seemed to have double representation and a conflict of interests, both as members of the board that picked bidders and as the bidders themselves. This is typical of client-owned organizations, and the conflict of objectives leads to failure. Second, the rules of PMP were dictated by the Swiss donors, and this discouraged the use of PMP by some other donors.

PMP shows how an apex organization can fail due to poor design of the governance structure and due to a lack of coordination among donors. It makes some sense to ask MFOs that will get donor funds to bid. It helps efficiency to fund those MFOs that promise the most outreach per dollar donated. At the same time, part of the judgement of the quality of the bids was done by the MFOs themselves, and this did not sit well with the MFOs that lost the bidding. Furthermore, it is not clear that donors other than the Swiss were committed from the start to the use of PMP as a channel for least part of their support of MFOs.

The PMP did not address the major constraints that limit microfinance in Bolivia. Its main purpose was to inject funds, not to strengthen organizational capacity and sustainability. PMP did not even manage to inject a lot of money. PMP did not strengthen the MFOs, nor did it try to do so. PMP likely did not reduce transactions costs for donors, since it disbursed just about US$1.5 million and yet incurred all the costs to set up the whole structure. PMP did reach some of the second-echelon MFOs in Bolivia.

B. Programa de Apoyo a las Microfinanzas; an embryonic microfinance apex

PAM is a systematic and ambitious attempt by the Government of Bolivia to play a more important role in the allocation of donor funds earmarked for microfinance. As such, its design does not focus on the possible key roles of financial intermediation and market development.

1. Structure

PAM is meant to improve access to formal financial services for the poor through a program of strengthening MFOs (FONDESIF, 1995). PAM is housed and managed within the Development Fund for Financial Institutions and for Support of the Productive Sector (FONDESIF, *Fondo de Desarrollo del Sistema Financiero y Apoyo al Sector Productivo*). FONDESIF is a government office specialized in the support of supervised financial organizations. Much of the support for the creation of PAM came from German donors (GTZ) interested in a broad support of the sector rather than of specific organizations.

PAM is designed to work with financial NGOs and with cooperatives, especially open cooperatives. The usefulness of PAM as an apex organization to serve open cooperatives is not clear. Open cooperatives are already supervised and thus already have access to other apex organizations whose role is restricted to supervised MFOs. Open cooperatives also have access to the technical services of second-tier institutions specialized in credit unions. If PAM is a short-term source of support for MFOs on the path to becoming supervised and to getting their funds from market sources, then it does not make sense for PAM to serve open cooperatives. Furthermore, this concern ignores problems of organizational design of financial cooperatives as client-owned institutions which may jeopardize their sustainability.

2. Functions

PAM has yet to start its work, and its final form and rules remain under discussion. In general, though, PAM is meant to support MFOs through the following functions:

(a) Loans to MFOs to tide them through liquidity crunches in the short term, much as inter-bank loans do for commercial banks.

(b) Cash gifts for technical assistance and for the costs to open branches in new markets. As with PMP, the gift carries the condition that it will become a liability subject to repayment should the MFO break its promise. This is not a very credible threat.

(c) Support to the microfinance sector as a whole through interaction with the supervisory and regulatory authorities.

(d) Conditioned loans that count as equity in the system used by the SBIF but which must be repaid in 5 to 15 years.

In principle, PAM could provide important technical assistance, especially to small NGOs in rural areas, which are the main source of political support for the creation of PAM. These NGOs claim that the rural areas are still far from being saturated with microfinance and that the MFOs there do not have good alternative sources of funds. Most of these rural NGOs appear to be more interested, however, in access to cheap funds than in technical assistance for sustainability.

3. Possible weaknesses

In practice, PAM may lack the technical expertise needed to strengthen MFOs. PAM works out of FONDESIF, and FONDESIF in the past was a clinic that administered bail-outs for sick supervised financial organizations. While more recent efforts have stressed the prevention of problems before they happen, it is not clear that PAM and FONDESIF have the experience to provide useful technical assistance for MFOs or even for more traditional financial organizations. Moreover, the experience of FONDESIF is with traditional financial organizations and traditional technologies, not with MFOs and their innovative technologies.

On the ground, donors are skeptical about the quality of the human resources lodged in PAM. The Central Bank did have an office and personnel that served an apex-like function for commercial banks. This expertise, however, was not transferred to PAM but to NAFIBO, the other government apex that might serve MFOs (see below).

PAM can reduce transactions costs for donors only if it can become a one-stop-shop for both donors and MFOs. The government at the time PAM was conceived wanted all external gifts destined for microfinance to pass through PAM. The international donors that might support a national microfinance apex such as PAM, however, want to reserve the right to place their funds directly with MFOs.

Unless a donor needs a sovereign guarantee on a huge loan earmarked to support microfinance, it seems unlikely that a donor would want to work with PAM or with a like apex. One donor may want to start an apex, but other donors may not find strong selfish reasons to channel their funds through the same apex. Without a pre-commitment from all big donors to work through an apex, MFOs can always play the apex and donors off against each other. Neither donors nor the apex will be able to instill discipline in their MFO customers, and this will harm sustainability on all fronts.

Another serious danger is political intrusion in PAM. The microfinance sector attracts the gaze of the government for at least two reasons. First, MFOs get large flows of foreign aid. Moreover, some microfinance organizations have been very successful in Bolivia. Governments usually want the share in this success, and government frequently like to offer microfinance as a tool to alleviate poverty (Gonzalez-Vega, 1997c).

Second, MFOs reach hundreds of thousands of households in a small country. The government may see PAM as a way to divert microfinance in Bolivia to its own ends. The government says this is not the case, but its acts say otherwise. For example, the government has insisted repeatedly that it would not intervene in financial markets through directed credit, but PAM would give it influence over donor money and thus over domestic MFOs. Furthermore, the decree that created PAM gives the government the right to buy an equity position in an MFO through PAM. The fragility and vulnerability of PAM to political pressures were shown by the replacement of its director in August of 1997 by the new administration.

PAM is meant to provide support to MFOs only until they become supervised and can take deposits and/or access apex organizations meant for supervised financial organizations. Given this fact, the usefulness of 15-year loans is unclear. Also, the use of conditioned loans that must be repaid but which count as equity for the SBIF seems to be a way to evade capital requirements of the SBIF and so to help MFOs to get supervised. This supervision would qualify an MFO to borrow from PAM. Thus, the conditioned loans seem to be not a way to circumvent a silly rule of the SBIF that prevents strong-but-low-capital MFOs from becoming licensed but rather a way to increase the possible market for PAM itself.

From the point of view of a donor, an apex like PAM is a risk. The donor no longer wields direct control over its funds, and the apex may make choices that would not match with what the donor would want. A good apex needs to become the sole source of public support for MFOs, but donors may resist pre-commitment to an apex with unproven capacity. Donors may not want to put all their eggs in one apex basket.

PAM has no clear owner whose funds are at risk. Donors would provide funds, and they would sit on a board of trustees. Their influence, however, would compete with that of the representatives of the government, the Central Bank, and MFOs. In any case, donors have few selfish reasons to act as strict owners in the long term. The final make-up of the board of PAM has yet to be determined, but it will have an important role in the strengths and weaknesses of PAM.

PAM also shows the high costs incurred to construct an apex. Government, donors, and MFOs must all negotiate together. No one knows whether these transactions costs will pay off with cost-savings in the future. While donors and government haggle over PAM, microfinance in Bolivia goes on, perhaps for years.

C. Fondo de Microcrédito, fine tuning a government apex

In April 1998, the Bolivian Government announced the creation of the *Fondo de Microcrédito*. The new apex mechanism is scheduled to start operations next June. Although the mechanism is still under design, four differences stand out with respect to the other apex initiatives:

(a) An array of diverse donors have already committed funds to support the new mechanism. Until now, US$ 32.4 million have been committed: US$25 million from the IDB, US$4.4 million from the German Development Bank (KfW, *Kreditanstalt für Wiederaufbau*) and US$3 million from the Canadian Government. While other donors are expected to contribute, the commitment of these three agencies has been enough to show the willingness of the donor community to back the mechanism. Besides the government, the two networks of MFOs (CIPAME and FINRURAL) are actively participating in the design of the FM.

(b) The FM is being designed as a center to support medium and microenterprises through loans from MFOs, direct technical assistance to enterprises and improvement of the legal framework under which they operate. The support of MFOs is aimed to relaxing their lending constraint, technical assistance is expected to relax production constraints, and the revision of the legal framework is expected to relax constraints on contract design and enforcement that may be biased against small enterprises.
The promotion of MFOs is, in principle, only a rehash of the PMP and PAM functions: funding and technical assistance to MFOs with an emphasis on the rural areas. The major difference is that the non-financial activities directed to medium and microenterprises were not present in the other initiatives (PMP and PM).

(c) The lending function is expected to be carried out directly by NAFIBO and not by the soon-to-be created mechanism. Currently, NAFIBO is the main government apex, and it works with supervised financial intermediaries only. The intention is to reach mostly FFPs, open cooperatives, and financial NGOs. Financial NGOs are not supervised now and their legal status is not clear. The idea of supervising them and of granting them a special charter is floating again. This initiative may have adverse effects on the creation of large and sustainable MFOs.

(d) Another goal of FM is to serve as a center for practitioners, donors, and the government to pursue changes in the legal framework that may enhance the development of small and microenterprises. Two tasks have been already identified: the design and enactment of the law for liens on movable assets (*prendas*) and the establishment of a trustworthy registry mechanism as well as the introduction of the charter for financial NGOs.

It is still too early to judge the FM, but its basic design already shows some blueprints of what can be expected. The targets of the effort are the small and microenterprises and not the MFOs. The MFOs will be supported only inasmuch as they support the small and microenterprises.

1. The Big Picture for PAM, PMP, and FM

The search for the best approach to the optimal use of PAM, PMP, and FM depends in all three cases on the basic framework to be followed for the development of the microfinance sector in Bolivia. The problem is that this basic framework has not yet been well defined nor agreed upon by many of the actors in the sector. The framework must provide guidance for the answers to two questions. First, does the sector need one apex organization or more than one? Second, should an apex or apexes support many small MFOs in the hopes that letting a thousand flowers bloom will allow at least a few to grow big and strong? Or, given the plethora of existing financial NGOs in Bolivia now, should an apex pick a few of the best MFOs and cultivate them carefully while letting the rest to their own devices?

a. How many apexes?

It might make sense to have more than one apex as long as they divided the jobs between themselves. For example, one apex might focus on financial intermediation and make loans to a few large, strong, licensed MFOs. This apex would be expected to be self-sustainable. A second apex might tackle the problem of the market creation. This job is decidedly more risky. The division of jobs between the two apexes would prevent the intrinsic non-sustainability of the market creation function from destroying the possibility of sustainable financial intermediation between donors and government, the apex, and the strong MFOs.

On the one hand, it is not clear that it would be best in Bolivia to pursue both possible functions of an apex, financial intermediation and market creation. At this point, there are some signs that market creation may be almost finished, and what is needed is strengthening and consolidation of the market as it is so that it will last through time. Furthermore, the placement of all efforts in a single organization may serve to reduce costs and to provide a central locus for policy discussions and lobbying for the microfinance sector. Such a possibility for coordination among donors and government is rare but valuable as many agents with good intentions often work at cross-purposes and undermine each other without some formal mechanism that forces them to make sure they cooperate.

On the other hand, it is risky to put all the apex eggs in one basket. Not only might the apex fail to be as useful and as strong as hoped, but also its size and weight could mean that it would drag down a large part of the microfinance sector with it. The chances for failure are high, given that any apex would be born big and with a big budget. The lack of private ownership and the involvement of the government and many donors means that there will be no easy way to get agreement for quick changes and adjustments in response to mistakes and the lessons that will crop up early in life. Furthermore, the lure of cheap funds could allow the apex to break good habits developed by MFOs through years when such cheap funds were not as easy to get.

b. How many MFOs?

In ten years, probably the urban microfinance market in Bolivia will not sustainably support more than four or five MFOs. Rural microfinance markets might support a slightly larger number of MFOs, given the many niches created by geography and that rural distances may limit the growth of a single MFO. A decade from now, it seems unlikely that rural Bolivia would need more than five to ten strong MFOs.

In the best of all worlds, if MFOs make profits from loans and deposits for poor households, then commercial banks may well learn to downscale on their own. This would render most MFOs obsolete. In short, there may be a role for an apex to support 5 to 15 of the best MFOs it can find now for five to seven years.

Strong, prudent MFOs can get all the funds they need from the market, so an apex should provide its support not as funds but as technical assistance. Time and growth will stretch and strain the institutional capacity and organizational structure of the second-echelon of MFOs. An apex may not want to waste its time, effort, and funds in an attempt to strengthen smaller and weaker MFOs. They will probably disappear with or without help from an apex organization. Such a strategy would require the apex to create its own obsolescence, and it might not match well with the goals of the employees of the apex organization. This lack of compatible incentives would jeopardize the performance of the apex. Focusing on strengthening potential winners would be more compatible with sustainability.

D. Fondo de Desarrollo Campesino, an apex for MFOs in rural areas

FDC is a parastatal created in 1989. At first, it had two basic goals:

(a) To invest in basic rural infrastructure. This included not only building physical infrastructure such as rural roads but also providing services such as extension or technical assistance.
(b)To temporarily provide the services formerly offered by *Banco Agrícola de Bolivia*, in the expectation that a private supply would eventually develop.

The attempt to lend for agriculture failed. By 1993-94, more than 90 percent of the portfolio of the FDC was in arrears. In 1992, a group of donors led by the Germans convinced the government to get the FDC out of direct lending. Failure of this lending program was explained by the same organizational shortcomings of government-owned development banks.

In 1993-97, the FDC spent US$24 million on physical and organizational infrastructure.. It also lent US$3.2 million to supervised financial organizations that lend in rural areas, US$ 589,849 lent in special programs (quinoa and livestock) and US$141,028 spent in technical assistance for MFOs and cooperatives. Most of this microfinance activity likely took place in the time before the FDC was restricted to work with supervised financial organizations.

The FDC can also give cash to rural MFOs. The purpose is to bolster their net worth and thus to support their efforts to clear hurdles on the road to supervision. As in the case of PAM mentioned above, it is not clear whether the push for supervision comes from the wish of the MFOs to take deposits on the market or from the wish of the FDC to increase the number of supervised organizations allowed by law to borrow its cheap funds and to delegate some screening functions to the regulator.

The twin objectives of the FDC may be in conflict (Zeitinger and Nieple, 1990). On the one hand, the FDC gives grants for infrastructure. These will not be repaid, nor does the FDC expect repayment. On the other hand, the FDC lends funds, and these ostensibly should be repaid. The problem is that the FDC, since it gives so many grants, is not credible as a lender that expects to be repaid. This lack of credibility encourages default.

In sum, the FDC has done little to strengthen microfinance in rural areas. It started as a renamed Agricultural Development Bank, and later it became a rural apex organization with both financial and non-financial targeted activities. With few supervised MFOs in rural areas, the FDC has been completely unimportant as a microfinance apex. It has not lent much funds to MFOs, and it has not strengthened MFOs so that they can handle more funds and perhaps raise their own from the market. If a rural MFO were to become supervised, the cheap funds it could then get from the FDC would discourage its taking deposits from the public. The absence of a strong repayment expectation means that the disciplining role of a loan is not achieved.

E. NAFIBO; an apex for supervised financial organizations

NAFIBO is a second-tier bank that makes medium- and long-term loans to supervised financial organizations. It is a conversion of the Development Office of the Central Bank, so it has some experience and technical expertise in lending to financial intermediaries, although not specifically in microfinance. Thus, NAFIBO may have the basic knowledge needed to provide competent, relevant technical assistance to MFOs. NAFIBO will perform the same function as did the former office of the Central Bank from which it was formed. The move out of the Central Bank is meant to reduce political influence on the use of funds as well as to make the process of allocation more efficient and transparent. It also responds to the general trend of taking development functions away from the Central Bank in order to protect its independence and its main monetary role in fighting inflation.

NAFIBO was formed in September of 1996 as a joint-stock company with paid-in capital of US$31.4 million. The Government of Bolivia owns 80 percent, and the rest belongs to the Andean Development Corporation (CAF, *Corporación Andina de Fomento*). CAF is a strong player in financial markets and this strategic ownership is a signal of strength for NAFIBO By law, NAFIBO is supervised as a second-tier bank, although no specific regulatory framework exists for this form of financial organization. It is also supervised by the government audit office.

NAFIBO has a lot of money, but, like the FDC, it can deal just with supervised financial intermediaries—commercial banks and FFPs. As is the standard for inter-bank loans, NAFIBO lends at the inter-bank rate (*tasa pasiva*) and without real assets as guarantee. Unlike inter-bank loans, which are usually repaid in a few days, NAFIBO loans are to be repaid in 5-10 years. NAFIBO lends for multiple purposes, microfinance is a small portion of the portfolio.

The combination of low interest rates, no collateral requirements, and long terms-to-maturity may explain why so many MFOs want to convert to the status of FFP. These MFOs do not necessarily want to conform to the discipline and the supervision of the SBIF in order to earn the right to take deposits. They may accept regulation since they may covet access to soft funds from NAFIBO. If this is the case, then NAFIBO would defeat the purpose of strengthening MFOs until they qualify for supervision. Access to public support should reduce the need MFOs have for more public support (Otero and Rhyne, 1992). In contrast, NAFIBO would make access to public support available right when the MFO would qualify to be cut from public support.

NAFIBO does not seem to address, however, any major constraint faced by the microfinance sector in Bolivia. It can legally work with just three MFOs, BancoSol, Caja Los Andes and FIE. NAFIBO has nothing to offer these MFOstwo except cheap, long-term funds. These funds are a double-edged sword for MFOs. They facilitate growth at low financial costs but discourage market-based liabilities. For some, they are like giving candy to a child; the child likes it now, but it harms the health of the child in the long term.

The approach of the government to apex organizations for microfinance seems to be to make money available. In most cases, more public money will not strengthen the ability of MFOs to get their own money from the market, so this approach does not address the key challenge for MFOs. In fact, it hinders the development of microfinance in the long term since it creates perverse reasons to seek supervision and avoid funds from the market.

F. Funda-Pro, a non-government microfinance apex

This section traces the development of Funda-Pro, discusses its functions, and examines its role in the growth of the microfinance sector in Bolivia.

1. The development of Funda-Pro

a. FOCAS, 1984-1994

During 1984-1994, USAID sponsored a program called Market Town Capital Formation (FOCAS, *Formación de Capital en Areas Secundarias*). The Government of Bolivia managed FOCAS through the decentralized offices of the Departmental Development Corporations (CRD, *Corporaciones Regionales de Desarrollo*). FOCAS had US$21 million for medium- to long-term loans through commercial banks for activities in small towns and in rural areas.

While FOCAS was not a great success, it did manage not to lose most of its funds. In 1991, USAID and the Government of Bolivia started to look for a use for the funds that would remain when the FOCAS project ended in 1994. Since its termination was foreseen, Funda-Pro was created as "an *ad hoc* response, supported by the Bolivian Government and USAID, to give continuity to the FOCAS project" (Dávalos, 1996). The political negotiations leading to this outcome were prolonged and difficult, despite its *ad hoc* creation, therefore, Funda-Pro had high start-up costs.

Funda-Pro was not conceived as a response to constraints on the sustainable growth of the microfinance sector. Funda-Pro was not seen at first as a vehicle to support microfinance at all. It was just a place to park funds from a USAID project that ended with some funds intact. Funda-Pro was also an effort to get the funds in the private sector where they would be free from political pressures.

While Funda-Pro is a private organization, all its funds came from public organizations. The Government of Bolivia, however, did not want to shift millions of dollars from a government office to a non-government private organization. This fact may explain some of its resistance to the later attempts by Funda-Pro to create a bank and the simultaneous rejection of the SBIF.

b. Design, 1991-1992

At first, the main objective was to create a development bank owned by a foundation (the future Funda-Pro) and by two not-for-profit organizations. The development bank was envisioned as a source of loans for credit-constrained small and medium businesses. It was not to be a microfinance apex organization.

As the concept of the new bank was discussed, it became clear that the commercial banks in Bolivia would oppose the sudden creation of a big bank with equity donated by USAID and by the Government of Bolivia. In fact, had Funda-Pro created a bank , it would have been one of the biggest in Bolivia in terms of net worth. Also, there were doubts that Funda-Pro had the human and organizational resources needed for the creation of a bank.

An application to charter a first-tier bank was never submitted. Instead, Funda-Pro initiated all its operations, financial and non-financial, as a foundation. The failure to get the charter reflected the fear of Bolivian bankers that the financial arm of Funda-Pro, the bank, could intrude on their market. Bankers said this would be unfair since Funda-Pro, most likely the main owner of the bank, got all its funds from donors and government. In fact, this is exactly what happened with FondoMicro, an apex organization in the Dominican Republic. USAID created FondoMicro with millions of dollars of donated funds. When a market of creditworthy MFOs failed to develop, FondoMicro created its own bank aimed at small businesses.

c. Birth, January 1992

After years of preparation and negotiations, Funda-Pro was finally born in January of 1992 and it obtained its legal status on August of 1992 as a private, not-for-profit foundation with the broad mission "to develop social and economic programs in Bolivia." It is governed by a board of trustees made up of private entrepreneurs and professionals appointed by USAID and by the Government of Bolivia.

Funda-Pro has received about US$28.5 million, all of it ultimately from USAID:

(a) US$2.9 million in donations from USAID in two pieces: US$2.4 million in September of 1993 (at the time of creation of Funda-Pro) and US$ 0.5 million in February of 1994.
(b) US$4.9 million from a PL-480 loan. This loan has seven years of grace and five to repay, and the interest rate is one percent per year. This loan was effective as of April of 1993.
(c) US$20.6 million from a USAID loan for FOCAS that was converted to a donation to the government and then lent to Funda-Pro. The terms of the loan are softer than a marshmallow: 20 years of grace, followed by 20 years of repayment with an annual interest rate of one percent. This transaction was effective in January of 1994.

d. Funnel without a cause: 1992-1993

While USAID could endow Funda-Pro with funds, it could not give it a job that required the use of those funds. The creation of Funda-Pro as a place to park money without much thought for its use of the money is reflected in a sample of the virtual plethora of functions found in its original mission statement:

(a) To support the development of the private sector,
(b) To support small and medium enterprises in small towns and in rural areas,
(c) To support self-help groups such as unions or trade associations,
(d) To support economic activities involving women, and
(e) To support democracy.

Funda-Pro had but one tool to use to accomplish these diverse goals: money. At this time, Funda-Pro had not done much but come into existence. It was not much but a pile of money in search of development activities in which it could work.The multitude of broad goals shows the lack of focus suffered by Funda-Pro in its first days (Dávalos, 1996).

e. The microfinance mission, 1994

By 1994, Funda-Pro had been around for almost two years, and it had been three years since it had first been conceived. FOCAS had ended, and Funda-Pro had been entrusted with its funds. Funda-Pro narrowed its mission to support and to strengthen private entrepreneurs by getting them access to financial services which would not otherwise be available to them (Funda-Pro, 1996 and 1997).

In line with the two possible functions of an apex organization, Funda-Pro provides support for MFOs, supervised or not, in two ways:

(a) loans, and
(b) services meant to strengthen organizational capacity.

Why did Funda-Pro settle on microfinance? Two broad reasons are possible. First, the managers of Funda-Pro might have seen microfinance as an easy, sustainable choice. Microfinance is the current darling of the development community. It is often easier to lend than to spend for development. Even international donors, themselves apex organizations of a sort, prefer to lend funds rather than to complete projects themselves. Furthermore, if Funda-Pro could lend to sound MFOs that would repay, then its managers could prolong their employment as long as they wanted. In contrast, a non-loan program would, with time, spend all of its assets and disappear. In addition, by 1994 Bolivia was famous for microfinance and had a few strong MFOs that could borrow and repay.

The second reason for Funda-Pro to settle on microfinance could have been the realization of management of a comparative advantage in the provision of a service that would relax an important constraint on the microfinance sector. This constraint is not funds but rather organizational capacity and sustainability, so Funda-Pro needed to use its endowment to develop and to field a small cadre of technical experts to provide non-financial services to MFOs. Indeed, Funda-Pro has assembled a competent staff of technical experts. To date, however, they have done little, if any, actual technical assistance.

Funda-Pro has managed to avoid at least one of the constraints of the main government apex organizations: it can serve unsupervised MFOs. Thus, Funda-Pro can work with exactly those MFOs most in need of technical assistance. At the same time, the MFOs most in need of technical assistance are exactly those MFOs who are the worst credit risks and which cannot absorb a lot of funds. Thus, the candidates for technical assistance from Funda-Pro may not be candidates for financial assistance, and the candidates for financial assistance may not need much technical assistance.

f. The quest for a legal status and supervision, 1992-1996

Since 1992, Funda-Pro has searched for an appropriate charter for its financial operations. After the first-tier bank idea was discarded, Funda-Pro supported the creation of a second-tier bank. This type of charter did not yet exist in 1992. The 1995 update of the Law of the Central Bank Law recognized second-tier banks, but it did not provide a regulatory structure tailored to them. In late 1994, Funda-Pro applied to the SBIF in order to create the second tier-bank, but the application was rejected in September of 1995. This rejection was explained by observations made by the SBIF in the project presented by Funda-Pro. Such observations were answered by Funda-Pro, but with no response from the SBIF yet.

i. The politics

One of the main arguments from the SBIF for its rejection was the lack of a regulatory structure for this type of organization. For its part, Funda-Pro argued that the rejection could reflect political factors. Funda-Pro faced two factors against it. The first and most important factor was its potential conflict with the apex function performed by NAFIBO, a government organization. The second factor was the fact that Funda-Pro was a non-government apex organization created with public funds. The regulatory authorities (The BCB and the SBIF) would rather support NAFIBO, the child of the Central Bank groomed to act as a credible second-tier organization to manage funds for supervised financial intermediaries. Funda-Pro was seen as a threat since it, as a non-government second-tier bank, might attract some donor funds away from NAFIBO. The government would prefer donors to fund the government, not non-government organizations such as Funda-Pro. In fact, Funda-Pro might never have been born had NAFIBO existed at the time to receive the funds left over from FOCAS.

Frustrated, Funda-Pro tried to sidestep the SBIF with an appeal through the Central Government. The executive branch issued a decree that authorized Funda-Pro to act as a second-tier financial organization. In April 1996, the SBIF rejected the terms of the decree. The SBIF argued that only it or the Central Bank could authorize the function of a financial organization. Furthermore, the SBIF claimed that it supervises organizations, not funds as the decree required.

A few months later, the Ministry of Finance supported the validity of the decree. Its reasons were purely practical; the government wanted to allow Funda-Pro to be supervised so that donors would not rescind promises of funds for Funda-Pro and to keep the funds already lodged in Funda-Pro from standing idle. For example, the IDB has expressed a willingness to arrange for a line of credit to Funda-Pro as soon as it gets a license from the SBIF.

The debate has not stopped, and the SBIF and Funda-Pro are still debating about a new regulatory framework. The final solution will be connected to the fate of at least three other government apex organizations: PAM, FDC, and the National Housing Fund.

ii. Lessons

The quest for supervision of Funda-Pro holds at least five lessons. First, donors cannot put funds in non-government hands and expect the government not to care. In general, non-government organizations have better incentives for efficiency and sustainability than government organizations. Yet donors cannot overlook possible political problems when public funds go to private hands. Supervision, however, constraints the behavior of the publicly-funded private owners.

Second, it costs a lot to set up an apex organization. All the maneuvers required for an appropriate legal status and supervision have not yet improved the ability of Funda-Pro to strengthen MFOs. Instead, they have created huge transaction costs and occupied human capital that might otherwise have worked directly to strengthen MFOs. These costs are borne not only by donors but also by MFOs, the government, and others involved with microfinance as they are consulted and drawn into planning meetings. The longer the gestation of an apex organization, the greater the impact the apex must have to justify these start-up costs, and the less likely it is that it will indeed turn out to have been a worthwhile investment. In the case of PMP and PAM, the start-up costs were wasted since the new apex organizations died essentially unused. With supervision, Funda-Pro would be able to attract donor funds and justify the efforts.

Third, while supervision can signal safety and soundness, that signal it not the chief function of supervision. Like the MFOs that want to be supervised so that they can get access to soft funds from NAFIBO, one reason that Funda-Pro wants to be supervised is to get access to a line of credit at soft terms from the IDB. This pursuit of supervision by Funda-Pro seems to be a perversion of the main intent of supervision. Funda-Pro does not take deposits from the public, nor does it plan to do so. Its collapse or mismanagement would not likely reverberate through the financial system as a whole. Indeed, an unsupervised Funda-Pro could have the best of both worlds. It could lend as it pleased and snub the standards and the required reports of the SBIF.

Fourth, the supervision of a microfinance apex organization may need to differ from the supervision of a traditional commercial bank for the same reasons that the supervision of retail MFOs may need to differ from that of a bank. But it costs a lot to make a special regulatory structure to serve one or two entities. Costs increase with the political wrangling that comes with supervision and the attendant quasi-rents.

Fifth, an apex needs the support both of the government and of all donors. For example, PMP failed because no one but the Swiss supported it. Likewise, PAM seems doomed because no one wants to sign on. The government hopes to be more succesful in attracting donors with the FM. When an apex organization such as Funda-Pro feuds with the government, donors cannot help but start to edge away. The lack of agreement means Funda-Pro must spend its time and effort to build support for itself, rather than to support the building of strong retail MFOs.

2. Functions of Funda-Pro

a. Financial services

Funda-Pro lends to five types of financial organizations.

i. Clients inherited from FOCAS

These borrowers are not MFOs but rather commercial banks. Their importance for Funda-Pro has declined with time. In 1994, when FOCAS ended and its portfolio was entrusted to Funda-Pro, these clients had about US$10.8 million outstanding. This was about 90 percent of the Funda-Pro portfolio. By August 1997, FOCAS clients accounted for US$3.4 million, or about 14 percent of the outstanding portfolio.

In general, loan recovery has been brisk, and current arrears have averaged about 7 percent of the portfolio. The defaulters have been bankrupt commercial banks, and Funda-Pro works through the SBIF in negotiating the terms of the partial recovery of these losses.

ii. LAAD America

LAAD is not an MFO but rather an unsupervised financial organization that lends for import and export operations. LAAD has loans outstanding equal to 10 percent of the portfolio of Funda-Pro. LAAD negotiated this loan directly with USAID, and Funda-Pro had little say in the outcome.

iii. Commercial banks

Except for BancoSol, commercial banks are not MFOs. Still, Funda-Pro lends them funds on the condition that an equivalent amount be lent to members of its target group. Funda-Pro does this not through loans but through conditioned time deposits (*certificados con obligación de hacer*). Conditioned time deposits are convenient since there are less taxes on interest on deposits than on interest on loans. Furthermore, the deposits are liquid and of low risk. Funda-Pro can sell them in the market should it need its funds before maturity. The threat not to renew can discipline MFOs. Conditioned time deposits work just with supervised financial intermediaries. The mechanism is also used with the then two supervised MFOs: BancoSol and Caja Los Andes.

Money is fungible, so it is unknown whether the conditioned time deposits increase the amount of microfinance in Bolivia. Perhaps commercial banks would have made the loans they count toward the requirement of the conditioned time deposits whether or not they got the funds from Funda-Pro.

Perhaps most importantly, the goal of a downscaling effort with commercial banks should be more than just to give them funds to compensate for the greater difficulties they incur to reach a target group. Downscaling should also help the bank to adjust its standard lending technology so as to lower its costs to reach the microfinance market (Navajas and Gonzalez-Vega, 1998). Otherwise, the downscaling will end as soon as the funds from the apex organization wane, and the commercial bank will learn nothing other than that the microfinance market is indeed more costly to reach. This will result in no additional, sustainable microfinance capacity in banks. As of August of 1997, commercial banks (excluding BancoSol) accounted for 26 percent of Funda-Pro's portfolio.

iv. Cooperatives

Funda-Pro started to work with some of the largest cooperatives in 1996-1997. Rather than work through conditioned time deposits without guarantees as with the commercial banks, Funda-Pro has used straight loans backed by time deposits (3 cases) and one by mortgages. This is a sound guarantee, and Funda-Pro is not taking much risk. As of August 1997, 19 percent of the portfolio of Funda-Pro was lent to cooperatives.

v. NGOs

Funda-Pro has lent to financial NGOs since 1994. Its first two NGO clients were PRODEM and Pro-Crédito, the mother of Caja Los Andes. Since then, Funda-Pro has also lent to PRODEM, FIE, Sartawi, Agrocapital, and IDEPRO. Caja Los Andes is an FFP, in March 1998, FIE received its license to operate as an FFP, and all of the rest are in the process of becoming FFPs. In the case of FIE, Funda-Pro have made loans at times and amounts that were critical for its development.

Funda-Pro serves the biggest and the best financial NGOs. It lends to supervised NGOs or to those that are almost supervised. Funda-Pro has little to offer these MFOs in the way of technical assistance, and its financial assistance is mostly useful as a source of quick liquidity. These NGOs can get funds from other sources, but Funda-Pro seems to have an advantage in the promptness of its disbursement.

If these loans are short-term, as true loans for liquidity crunches would be, then it would appear that the main impact of Funda-Pro has been to relax some temporary liquidity constraints for the biggest and best MFOs. If these loans have been long-term, then it seems more likely that Funda-Pro gives the best NGOs not better access to funds but rather just lower prices.

Table 2: Portfolio of Funda-Pro - Selected years.

As of	December 1994		December 1996		August 1997	
	US$[a]	%	US$	%	US$	%
Commercial Banks[b]	1,141,500	8	4,541,500	23	5,791,500	26
MFO's	3,191,679	22	5,231,900	26	7,283,800	32
BancoSol	2,000,000		0		0	
Caja Los Andes[c]	750,000		1,600,000		1,750,000	
NGOs	441,679		3,631,900		5,533,800	
Cooperatives	0	0	3,550,000	18	4,300,000	19
Others	9,985,840	70	6,502,350	33	5,320,950	23
LAAD	2,475,000		2,485,000		2,485,000	
Edu-Crédito	5,703		66,341		223,801	
FOCAS	7,505,137		3,951,009		2,612,149	
T O T A L	14,319,019		19,825,750		22,696,250	

a) figures are expressed in nominal US dollars
b) BancoSol is not included in the figures for commercial banks.
c) In 1994 Caja Los Andes was an NGO (under the name of Pro-Crédito), in 1995 it became the first FFP.

vi. Discussion

Several financial NGOs, two FFPs and one commercial bank, BancoSol, are the only pure MFOs served by Funda-Pro. On average, in 1993-97, they accounted for about 22 percent of its portfolio. This figure does not include the conditioned time deposits with commercial banks, and these may also have increased the supply of microfinance.

The impact of Funda-Pro on the size of the microfinance market has been slight at best. Funda-Pro plays a small role in the total funding of MFOs. At the end of 1995, it funded about 6 percent of the total portfolio of MFOs. This increased to about 10 percent at the end of 1996 and 1997. It is likely that the MFOs that used Funda-Pro could have got most, if not all, of this small amount of funds from some other source, had Funda-Pro not been an option. Funda-Pro would have a greater chance to relax a constraint on funds if it worked with weak MFOs, but it works with strong MFOs known to be good credit risks. This prudent behavior guarantees its sustainability.

Nor has Funda-Pro had an important role in the growth and strengthening of the strong MFOs it now serves. For the most part, its customers were already well-established by the time it started to lend. Funda-Pro has not run programs of technical assistance, and it has not dealt much, if at all, with the small, weak NGOs that might have a use for support in their organizational capacity and sustainability.

According to its clients, Funda-Pro has indeed helped to meet their demands for quick, short-term liquidity. Still, these MFOs have access to many sources of funds outside of the apex, including deposits from the public, NAFIBO, and inter-bank loans. Without the help of Funda-Pro, they would have made slightly fewer loans, had slightly smaller profits, and grown slightly slower, but they would not have collapsed or ceased to grow. BancoSol, for example, takes deposits from the public, borrows from other banks, and has placed bonds overseas. It seems unlikely that the increase in the speed of disbursement of a small amount of funds for a few strong MFOs would compensate for the expense to start the apex nor the continued opportunity cost of its funds and human capital.

b. Non-financial services

Funds are not the main constraint faced by MFOs in Bolivia. Thus, in principle, non-financial services that address non-financial constraints are important for an apex organization such as Funda-Pro. In practice, Funda-Pro has provided few non-financial services. It plans to increase its work in training, education, and research in 1998 and in the next years.

Funda-Pro may have a comparative advantage as a focal point for the production of public goods for the microfinance sector in Bolivia. For example, it could be a center for donor coordination, whether or not it handles donor funds. It could also serve as a library and clearinghouse for the stacks of reports done on MFOs in Bolivia. These information, education, and coordination functions require an endowment, but not nearly so much as what Funda-Pro now has. These functions are not trivial, however, especially since Bolivia has become a showcase of microfinance for the world.

Non-financial services that Funda-Pro already provides include:

(a)Training of personnel at non-bank financial organizations through a program started in early 1998. The program, implemented by the Bolivian Institute of Business Studies (IBEE, *Instituto Boliviano de Estudios Empresariales*) was funded by USAID. Funda-Pro helped with its design and organization.
(b)Running a microfinance forum which funds research in microfinance and provides a neutral place for the exchange of ideas. Funda-Pro plans a survey of microenterprises in the whole country as a public good for the sector.

Some other types of non-financial services have been planned but not yet implemented.

3. The role of Funda-Pro in the growth of the microfinance sector in Bolivia

a. Past

Funda-Pro has played a very small role in the development of the microfinance sector in Bolivia. That role has been limited to a small amount of loans to the biggest and best MFOs. Without Funda-Pro, these MFOs probably could have got funds from some other source, albeit not as quickly. Funda-Pro has done very little to strengthen the organizational capacity of these MFOs, as they had already developed this capacity.

Funda-Pro was conceived from the need to park funds from a completed project and the desire to do so outside of the government. In this sense, Funda-Pro has been a great success. To its credit, Funda-Pro has continuously searched for a more meaningful mission. The process, however, has been long and costly, and it still remains incomplete.

b. Present and future

i. Sustainability

A sustainable link between the two possible functions of an apex organization, financial intermediation and market development, seems difficult. The financial-intermediation function gives the apex organization scope for sustainability, but it may not develop the microfinance market much. In certain circumstances, this intermediation function is valuable per se and sustainable (Gonzalez-Vega, 1998). In contrast, the market-development function strengthens MFOs, but it drains the apex until it shrinks and dies since the apex cannot hope to recover all of the costs of its non-financial services. Sustainability matters in this case, as well, but sustainability is much harder to achieve.

Unlike giving technical assistance, lending funds can be profitable. Thus, if the managers of Funda-Pro want to keep their jobs for a long time and thus aim for sustainability, they will resist giving away technical assistance. Instead, they will be more eager to lend, at least to strong MFOs. Conversely, they will resist pressure to disburse to risky MFOs. Funda-Pro has done this. The tightest constraint on microfinance in Bolivia, however, is not funds but organizational capacity and sustainability. This means Funda-Pro has been sustainable but it has had low impact.

The strongest MFOs in Bolivia do not face severe constraints on funds. They can get funds almost anywhere they want. But they still like to borrow from Funda-Pro. The terms and conditions of loans from Funda-Pro are more attractive than those of private lenders. Funda-Pro can do this and remain sustainable since it makes large loans and since its does not pay for its funds. Funda-Pro can beat the price of a commercial bank since it pays just for administrative costs, not for both administrative costs and financial costs.

In fact, Funda-Pro is likely sustainable since it is financially self-sufficient and since it has an organizational design that creates a structure of incentives such that its key stakeholders have selfish reasons to act in ways that promote good performance now and in the long term. There are compatible incentives for good staff performance and sustainability. Funda-Pro is financially self-sufficient since it earns enough profit to maintain the real value of the public funds lodged in net worth, as it pays market prices for all other funds and as it stays in its market niche (Schreiner, 1997). Funda-Pro can do this since inflation is low, it makes huge loans, and it charges a price that covers both inflation and administration.

Funda-Pro has no true owners, so its governance structure is weak. Still, Funda-Pro is not completely ownerless. Its managers want to keep their well-paid jobs and the perk of helping the poor. To do so, Funda-Pro must survive. If Funda-Pro dies, then its managers will need to look for new work. Thus, managers act like quasi-owners. Sustainability also matters to managers since Funda-Pro may not get more gifts from donors. It has an endowment, and it might need that to last its whole lifetime. This induces good managerial performance.

Funda-Pro also has an appropriate, standard technology. It lends to MFOs without demanding as much collateral as a commercial bank would. This is the standard technique for inter-bank loans. The risk depends on the safety and soundness of the borrowers. This risk is low since Funda-Pro lends just to the biggest and the best MFOs, and they seem unlikely to go bankrupt soon.

Not only is Funda-Pro sustainable, but it may also be self-sustainable. It is privately profitable since it could maintain its size if it replaced all public funds with market funds (Schreiner, 1997). In 1996, Funda-Pro showed a subsidy dependence index (SDI) of about 50 percent (Yaron, 1992). Given the actual yield on lending of about 11 percent, Funda-Pro could have earned a market return for investors had it increased the yield by 50 percent (Schreiner and Yaron, 1998). The implied subsidy-free yield is about 17 percent per year. The prime rate in Bolivia has been about 11 percent. Commercial loans would be about 14 percent, but they require more collateral, so a similar loan with little collateral could very well carry 17 percent or so. Also, most of the MFOs are not blue-chip, prime-rate borrowers, so the portfolio could earn 17 percent even if the best borrowers were charged a little less, since the worse risks would be charged more. In all likelihood, Funda-Pro could have earned the subsidy-free yield on its portfolio and still competed against commercial banks for MFOs.

The private profitability of Funda-Pro as measured by the SDI is a short-term measure. It suggests that private investors would have liked to have owned it last year. In contrast, the Net Present Cost to Investors (NPC_I) is a long-term measure. It is the present value of cash flows as seen by an investor. It assumes that private funds replaced public funds in 1993 and then that investors sold Funda-Pro at its accounting net worth in 1996. It also supposes that future performance was known at the start of 1993. The NPC_I has the same content as a measure of net present worth (Schreiner, 1997).

The NPC_I as seen from the start of the time frame of 1993-96 was about US$1.1 million for Funda-Pro. Since the NPCI is just the negative of net present worth (NPW), NPC_I=-NPW, and the NPCI means that the net present worth of Funda-Pro, as seen in 1993 (Funda-Pro was created in late 1992) from an investor who made investments in Funda-Pro that exactly replaced the investments made by public entities, and then liquidated it and pocketed the accounting net worth at the end of 1996, would have lost about US$1.5 million.

Table 3: Selected Indicators of Sustainability.

For the year ending	December 1993	December 1994	December 1995	December 1996
SDI	10.33	0.15	1.00	0.50
Actual Yield	0.05	0.12	0.08	0.11
Change in Yield	0.55	0.02	0.08	0.06
Subsidy-free Yield	0.60	0.14	0.16	0.17
NPC_I (1)	US$ 347,006	US$ 425,520	US$ 1,154,996	US$1,471,141

(1) Figures correspond to dollars as of the beginning of 1993.
Source: Author's calculations

Funda-Pro is probably self-sustainable. But self-sustainability does not mean that Funda-Pro has been a worthwhile investment from the point of view of society (Schreiner, 1997). A socially worthwhile intervention would have had more social benefits than social costs when seen from the time of birth until now. This does not necessarily mean that from now on Funda-Pro will not be worthwhile. The ease with which Funda-Pro could reach private profitability suggests that Funda-Pro may simply have substituted for private sources of funds that would have served the good MFOs in any case. For future worthwhileness, Funda-Pro will have to redefine its mission.

Thus Funda-Pro, while privately profitable and self-sustainable, was probably not worthwhile from the point of view of society. Funda-Pro has not pioneered new technologies for the support of MFOs. It has just lent funds to MFOs that probably could have got those same funds elsewhere at a slightly higher price. The funds and human capital lodged in Funda-Pro have a high opportunity cost, and their value added in Funda-Pro probably has not exceeded their cost.

ii. Market

The market of MFOs willing and able to borrow from Funda-Pro is small. This market may shrink even more as the best financial NGOs become FFPs since, once supervised, they can take deposits and borrow from NAFIBO.

Funda-Pro has used its funds in a function of financial intermediation. It could also use its funds to produce or to buy non-financial services in a function of market development. This function might address more directly the key constraints and weaknesses of most MFOs in Bolivia.

Non-financial services might take two forms. The first is technical assistance. Funda-Pro, however, cannot dictate a financial technology to an MFO, nor can it innovate for an MFO. Rather, Funda-Pro can serve as an extension office for technology that would be common for all MFOs. For example, Funda-Pro could help to develop sound accounting and reporting practices or quick management-information systems. The MFOs themselves would still have to figure out the best way to attract customers, to make loans, and to get repaid. The role of Funda-Pro would be just to help to ensure that the rest of the work-a-day jobs are done in a businesslike way. To do this, Funda-Pro would have to spend, not lend.

The second form of non-financial assistance would be through a role as a central point of focus for the microfinance sector. Funda-Pro could pay for research and other public goods that benefit the sector as a whole but for which no single MFO would be willing to pay. An example might be a credit bureau. Funda-Pro could also be a coordination center for donors and for researchers.

Funds are not the most important constraint for microfinance in Bolivia today, but funds have been the main tool in the hands of Funda-Pro. But funds are fungible, and having funds does not restrict Funda-Pro to lending funds. While Funda-Pro may be able to lend funds sustainably, especially if it lends only to the best MFOs, it may not be able to spend funds sustainably. Donors are in the same predicament since they also both lend and spend and require constant replenishments. If Funda-Pro were to continue to just lend to the biggest and the best, it probably would not do much more than donors could do on their own without the expense of the superstructure of an apex organization. If, however, Funda-Pro were to develop a way to strengthen the small, weak NGOs which require more time and detailed care through the long term than donors are prepared to offer, then Funda-Pro might add more value than it does now.

Funda-Pro might help commercial banks to downscale. But downscaling is also very difficult, perhaps even more difficult than upgrading. Good downscaling instills technological know-how in the bank. Otherwise, the bank just reaches poor households as long as the subsidized funds last. To help create this know-how, the apex organization might link subsidies not to loans but to measures of microfinance output of the bank. For example, the apex might require the bank to lend to poor households who were not customers in the past or to produce new products such as loans or deposits with smaller average balances. To induce these changes could require more subsidy than comes in a subsidized loan. In any case, there is no intrinsic reason to link subsidies to loans. In fact, there are important reasons to decouple them.

If Funda-Pro begins to spend to strengthen small, weak MFOs, then its own sustainability will suffer. The purpose of an apex organization is to do the job of donors more efficiently than donors. This job is not sustainable. The dilemma is that without the drive for sustainability, the incentives for efficiency and for discipline vanish. Donors could mitigate this by tying further support for Funda-Pro to its production of services meant to encourage innovation and meant to strengthen the sustainability and the organizational capacity of retail MFOs.

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