

FIE

CENTRO DE FOMENTO A INICIATIVAS ECONÓMICAS (Center for the Development of Economic Initiatives)¹

La Paz, Bolivia

The Executive Question

It was 8:30 a.m. when Jenny, the executive president's secretary, politely knocked on her boss' door to announce her arrival. She entered his office with his morning brew, an herbal tea, "mate de coca," that soothes the symptoms of altitude sickness commonly experienced in La Paz, which is more than 12,000 feet above sea level. She then reminded him that the regional directors of FIE—a Bolivian microcredit nonprofit lending institution—would be arriving within the hour for the annual director's meeting.

Enrique Soruco, executive president of this nonprofit institution, gazed across the stacks of papers on his desk, pondering the institution's latest challenges. FIE was facing pressing liquidity problems brought on by the organization's unprecedented growth in recent years and the unexpected decline in funding from international development organizations (IDOs). He was also concerned about the entry of other institutions into the microfinance business, transforming the industry from a colorful development fad into a highly competitive segment of the mainstream financial services industry.

He was further concerned that the government might formally begin to regulate the microfinance sector, constraining FIE's ability to compete by imposing strict new industry regulations. Government involvement might also create opportunities. It had recently created a new class of financial institution that was eligible to borrow funds from the country's Central Bank (CB) to lend to customers. Such firms could dramatically boost their lending capabilities. Enrique wondered if FIE should

become one of these institutions, and if it did, could it realistically access those funds, or would the banking sector attempt to prohibit such borrowing?

Enrique picked up the circular he had mailed out a month before to his regional office directors (Exhibit 1). Given the notice's focus on performance results and the following year's incremental plans, he wondered whether the directors would be surprised by his intention to begin a frank assessment of FIE's legal status and competitive position at the day's annual meeting.

He also wondered how they could possibly discuss and formulate next year's goals when FIE's largest regions actually had difficulties meeting last year's goals. FIE's long-term prospects were now more uncertain and unstable than ever before. Enrique knew that the directors would be pushing for more financial resources to consolidate their offices, even in the midst of the organization's liquidity crisis. Further complicating the situation, the regional offices in La Paz and El Alto were nearing the magic 2,000 loan limit per office. Previous experience had demonstrated that offices could only manage up to 2,000 loans effectively; larger portfolios became unwieldy, and FIE wanted smaller, informal and user-friendly environments for its clients. Consequently, FIE needed to open two additional agencies in the cities of La Paz and El Alto this year, creating another demand for substantial cash investment.

As the forerunner of Bolivia's microcredit industry, FIE's credit methodology had become an important topic of discussion in development-minded intellectual circles around the world. That attention paved the way for

Exhibit 1
PRESIDENTIAL CIRCULAR
CENTRO DE FOMENTO A INICIATIVAS ECONÓMICAS (FIE)

FIE/EP/003/96

TO: Oscar Vedia, Regional Office LA PAZ
Elizabeth Chacón, Agency EL TEJAR
Maria V. Rojas de Schulze, Regional Office EL ALTO
Victor Huanaco, Agency 16 de JULIO
Roxana Nava, Regional Office SANTA CRUZ
Maria del Carmen Nava de Pereira, Agency PLAN 3000
Guillermo Guerra, Regional Office ORURO
Carlos Decker, Regional Office COCHABAMBA
Marcela Cox, Regional Office POTOSÍ
Maria Eugenia Mariscal, Regional Office TARIJA

FROM: Enrique Soruco
EXECUTIVE PRESIDENT

RE: **Annual Executive Staff and Director's Meeting**

This circular is to inform you that the annual Executive Staff and Director's meeting has been officially scheduled for Thursday and Friday, February 25-26. I have set the following items for the meeting's agenda:

- (1) Review each Regional Office's and Agency's year-end operating results to the objectives that were set by the Credit Manager;
- (2) Recommend changes to the Finance Manager and the Head Accountant for the accounting systems and operation procedures based on last year's operating results;
- (3) Propose and approve next year's Credit Program goals and objectives for each Regional Office.

The meeting will begin at 9:00 a.m. and finish at 5:30 p.m. and there will be a three hour lunch break, from 12:00 p.m. to 3:00 p.m. Each Regional Office Director will be expected to present the office's year-end operating results to the Executive Staff and propose next year's goals. Please confirm your attendance with the Executive Secretary and direct any logistical questions to her as well. Each Director should contact the Credit Manager with any comments or questions regarding his/her office's and agency's year-end results or goals and objectives.

Sincerely,

La Paz, January 21, 1996

Enclosure: Credit Program Year-end Results and Review
cc: Credit Division Manager

ESV/jge

other international and local development institutions to launch programs in Bolivia, causing unanticipated, intense competition for limited IDO funds (both loans and donations) that were key to managing startup microcredit lending programs. FIE's credit program had benefited from these financial resources over the last ten years, allowing it to grow and prosper very well. But the program's resources were now being drained by other FIE divisions, notably the costly effort to provide entrepreneurial training to clients.

Further complicating the competitive situation was the unexpected drop in repayment of outstanding FIE loans. Historically, the default rate on FIE's loan portfo-

lio had been less than one percent, an outstanding result that was rapidly drawing the attention of the formal banking sector. Many of Bolivia's banks were searching for ways to increase their loan portfolios and interest income, and FIE's experience had demonstrated that microfinance activities could provide high return at low risk. This created new competition for FIE's best clients, while remaining clients had irregular repayment records.

The distinction between the formal banking sector and the informal microfinance sector was blurring, raising concerns and questions regarding financial reporting and operational procedures. Most microcredit institu-

tions were nonprofit institutions that did not fall under the jurisdiction of the Superintendencia de Bancos y Entidades Financieras (Superintendency of Banks and Financial Entities), Bolivia's highest government regulatory body overseeing the banking industry (i.e., banks, credit unions and other financial institutions). This situation appeared ready for change, and FIE could soon face a new set of operating obligations and constraints.

Enrique reflected on the dramatic impact these changing external circumstances had on FIE's operations. The changed environment might require institutional transformation, but what that meant in the short- and long-term was unclear in his mind.

FIE's Background and History

In the early 1980s, four young professional Bolivian women—Maria Eugenia Butrón (administrator), Maria del Pilar Ramirez (psychologist), Maria V. Rojas de Schulze (social worker), and Maria Rosa del Pilar Velasco (social worker)—found themselves working together at the refugee center in La Paz, CESEM, the Centro de Estudios y Servicios Especializados en Migraciones Involuntarias (the Center of Studies and Specialized Services in Involuntary Migrations). CESEM was an agency of the United Nations High Commissioner for Refugees, or ACNUR,² which assisted Bolivian refugees returning home after living in exile in neighboring countries. ACNUR provided donations to help them start small businesses. Through this experience these women developed the idea of helping Bolivia's poor by providing access to credit rather than direct donations (as ACNUR did) in order to encourage them to consolidate their economic activities and direct their own future.

Thus, on November 13, 1985, these four women along with another, Helga Beatriz Salinas (also an administrator), established FIE as a private, nonprofit institution. It was founded to offer quality financial and nonfinancial services to the poor to promote the sustainable development of Bolivian microentrepreneurs and small businesses. Targeted businesses were owned by persons, families or groups living in poverty who had limited access to traditional sources of credit and training (Exhibit 2). FIE carried out its mission through an integral aid program that promoted both the microentrepreneur's productive and commercial activities. Services included credit for working capital and fixed investments; entrepreneurial development technical training; production training; technical assistance in organizational development; quality control technical assistance; marketing advisory services and financial advice for microentrepreneur organizations. The founders wanted to improve the relationship between lenders and the working poor who needed access to credit.

FIE sought a distinctive way to achieve its objective of supporting and empowering underdeveloped urban areas. Traditional aid only seemed to weaken people and perpetuate poverty. FIE wanted to extend credit to support the poor's income-generating activities in ways that resembled the services of banks. Experiences from around the world taught them that enviable repayment rates, notable increases in family income and significant improvements in living conditions were all possible using microcredit. This foundation guided the development of FIE's own credit methodology.

Prior to the official charter date, the founders spent several years working with different international and local development institutions, experimenting with credit operations and learning banking operation practices. FIE then developed a credit methodology tailored to the needs of its clients. FIE also began to develop accounting and management training techniques for its clients. It shared its ideas and methodology with other credit institutions dedicated to developmental change, hoping to foster teamwork and unity among players while providing more opportunities for the microentrepreneur. In 1988, FIE's credit program initiated its operations in La Paz, offering artisan and production credit lines. In that same year, it also introduced management training courses to all credit program clients. Training remained an important feature of FIE's offerings, though in recent years it had become a significant cash drain.

Over its first ten years, FIE approved more than 43,400 credits and disbursed over US\$29.8 million. By early 1996, its capital totaled over US\$2.2 million and its loan portfolio amounted to US\$6.2 million, disbursed along four different credit lines: the production credit line, offering individual loans for producers and artisans; the commerce credit line, offering individual loans for merchants; the associations credit line, offering group loans for producers or small manufacturers; and the leasing credit line, offering lease financing. The last two offerings were fairly new. Thus far only four offices offered leasing loans and only one offered association loans, all within La Paz and El Alto, but there were plans to expand these products to other regions.

Exhibit 3 shows the kind of information collected by FIE evaluators for review and analysis before a commercial loan was extended. Evaluators first visited the applicant's business to examine machinery, equipment, materials, etc., and to learn how the applicant managed his or her business. The applicant was then invited to the office to conduct a feasibility study where terms of a loan were discussed. The evaluator considered the applicant's sales, costs, net income and personal expenses, and together they discussed the loan amount, loan term, interest rate, payment terms and collateral. Once

Exhibit 2 FIE'S STRATEGIC OBJECTIVE

FIE's strategic objective was to support the development of women, men, groups and organizations through economic empowerment, living condition improvements and the promotion of Bolivia's productive base. Its work was based upon the support of the following:

- to offer a microcredit support service to underdeveloped urban areas guided by a strong commitment to quality;
- to help the microentrepreneur reach her or his economic potential with the objective of contributing to favorable and sustainable social impacts;
- to offer a combination of actions including credit, training, technical assistance and commercialization, because together they better support the microentrepreneur's needs;
- to strengthen FIE's financial base so as to guarantee its capacity to finance future expansion into new services and other regions of Bolivia;
- to maintain a strong predisposition towards innovation and risk-taking in undertaking new challenges and
- to achieve the long-term sustainability of FIE's financial and nonfinancial services.

FIE'S CLIENTS

FIE's clients were the producers, merchants and artisans who lived in the economically poor areas of the cities and semi-urban zones of Bolivia that have limited access to the conventional financial system. They were women (60%) and men (40%) who developed their own economic activities to provide income to cover their basic living needs. The people adopted a production mode that did not clearly separate the owners from the labor force.

The owners hired few employees, if any at all, due to a lack of funds. Thus, many times they served as a worker and also enlisted their families as employees. The owners initiated production with great personal sacrifices, normally with very little capital endowment, in low-income market conditions, with little education and with deficient health services and work conditions. Most of the microentrepreneurs ran their businesses from home, which served a dual role as a productive unit and a source of income to cover the family's expenses.

Altogether, these activities represent 94% of the urban economic enterprises, employ 55% of the total urban labor force, incorporate 75% of the economically active women, and generate 65% of the national employment. They also produce a significant part of the country's Gross Domestic Product and provide the majority of the consumer products and services.



A carpenter and three employees financed by a FIE production credit

the information was gathered, a committee decided whether or not to approve the application. If the loan amount was over \$2,500, the credit manager also participated in the committee decision.

FIE's active clients totaled more than 12,090 in number and the average loan size was US\$688.60. Considering that FIE's clients had average monthly incomes of less than US\$200, a loan of US\$688 was a major investment. The average number of active clients per evaluator was 336, and their average loan portfolio was US\$173,605. Over the years FIE expanded its financial service operations to seven regional offices and three agencies in the following cities: Cochabamba, El Alto, La Paz, Oruro, Potosí, Santa Cruz and Tarija. Additional information about the character and performance of these regional offices appears in Exhibits 4-10.

FIE's Organizational Structure

FIE's decisionmaking body was the General Assembly of Associates. Its legal representation and administrative functions were entrusted to a Board of Directors, designated by the General Assembly and presided over by the executive president, Enrique Soruco. He had been brought in as an outsider after most of FIE's founders had had their opportunity to serve as executive president. FIE separated its financial services area from its nonfinancial services area, with each having autonomous management and different sources of financing. (See organization charts in Exhibits 11 and 12 and employee headcount in Exhibit 13.) The operating units within each area were as follows: the financial services area contained the credit division and finance and operations division, and the nonfinancial

**Exhibit 3
SAMPLE FEASIBILITY STUDY FORM-COMMERCE CREDIT LINE**

Credit #: _____

Date: _____

Name: _____

Start Date of the Business: _____

Owned: _____ Rented: _____ Other: _____

Type of Authorization RUC: _____

Patent: _____

Association: _____

Other: _____

Past Loans (amount, term and the institution's name): _____

Purchases and Sales:

Days of the Week	Purchases		Sales		Remarks
	Minimum Bs. (Bolivianos)	Maximum Bs. (Bolivianos)	Minimum Bs. (Bolivianos)	Maximum Bs. (Bolivianos)	
Monday					
Tuesday					
Wednesday					
Thursday					
Friday					
Saturday					
Sunday					
Total					

Average Weekly Purchases: _____

Average Weekly Sales: _____

What will you buy with the loan? _____

Principal Products:

Product	Purchases: Unit Cost	Sales: Unit Sales Price	Percentage of Earnings

What are your weekly earnings? Bs. _____

	Other Expenses	Amount	Payment Period
Assistant (Is he/she a relative?)			
Deposit			
Taxes			
Rent			
Caretaker			
Other (Please specify)			

Exhibit 3 (Continued)
SAMPLE FEASIBILITY STUDY FORM-COMMERCE CREDIT LINE

Weekly expenses: _____

Equipment that you have (cost) Bs. _____

How much working capital? Bs. _____

How much do you withdraw from your business for your personal expenses? Bs. _____

Number of dependents: _____

Do you have other income sources? (Please specify): _____

Other expenditures? (Debts, Family expenses, etc.): _____

Amount requested Bs.: _____ Amount recommended Bs.: _____

Term requested: _____ Term recommended: _____

Guarantee (Please specify): _____

Product Origin

National: _____ % Cash: _____ %

Imported: _____ % Credit: _____ %

Consignment: _____ %

Payment Capacity (in Bolivianos): _____ %

Weekly Gross Margin: _____

(-) Weekly Expenses: _____

Balance: _____

Amortization:

(-) Principal: _____

(-) Interest: _____

Balance: _____

(+) Other Income: _____

(-) Family Allotment: _____

(-) Other Expenditures: _____

Net Balance _____

Suggestions (Positive Aspects, Negative Aspects, Recommendations):

 Evaluator

**Exhibit 4
MAP
OF
BOLIVIA**



service area contained the entrepreneurial development and training divisions. The legal and auditor roles were provided on a contractual basis by external services.

The credit division was in charge of the loan portfolio, which included a variety of financial services for the microentrepreneur and small business. Loans were available to support production, commerce and leasing. The division had seven regional offices and three agencies. The finance and operation division was responsible for assuring the adequate cash flow for FIE's credit program and an efficient accounting system and management operation for the institution. The division was entrusted with the institution's administrative services.

**Exhibit 5
INCOME STATEMENT—FIE CREDIT PROGRAM**

Fiscal Year End	12/31/93	12/31/94	12/31/95	3/31/96
Income:				
Loan Interest Income	\$670,359	\$912,005	\$1,129,426	\$816,958
Other Interest Income	113,350	158,517	221,470	138,298
Total Interest Income	\$783,709	\$1,070,522	\$1,350,896	\$955,255
Financing Expenses:				
- Actual Interest Cost	\$154,888	\$268,730	\$436,406	\$311,831
- Market Price Adjustment	-	-	-	-
Total Financing Expenses	\$154,888	\$268,730	\$436,406	\$311,831
Net Interest Income	\$628,821	\$801,792	\$914,490	\$643,424
Rights and Other Operational Income	23,000	60,199	37,325	10,819
Net Income b/ Operating Expenses	\$651,821	\$861,991	\$951,814	\$654,243
Operating Expenses:				
Salaries:				
- Credit Team	\$279,042	\$349,790	\$385,408	\$215,606
Administration Costs	187,683	223,263	405,583	222,139
Depreciation	15,475	24,893	38,897	23,132
Provision for Bad Debts	30,790	39,384	56,039	28,115
Other Provisions	14,266	47,128	-	-
Other Operating Expenses	-	-	5,019	3,313
Total Operating Expenses	\$527,257	\$684,456	\$890,946	\$492,305
Income b/ Real Value Capital Mant.	\$124,564	\$177,535	\$60,868	\$161,938
Less: Real Value Capital Maintenance	157,774	140,197	26,264	(6,313)
Net Income b/ Operational Subsidy	\$(33,211)	\$37,338	\$34,605	\$168,251
Operational Subsidy	164,254	49,405	61,823	18,863
Net Period Earnings	\$131,043	\$86,743	\$96,428	\$187,115

Information Source: FIE's Accounting Management Report, March 1996

Exhibit 6
BALANCE SHEET—FIE CREDIT PROGRAM (in US dollars)

Fiscal Year End	12/31/93	12/31/94	12/31/95	3/31/96
Assets:				
Cash	\$101,418	\$70,218	\$282,893	\$97,973
Temporary Investments	-	100,000	568,578	461,944
Accounts Receivable	41,098	176,752	360,286	576,506
Other Current Assets	14,434	14,433	11,362	11,362
Loan Portfolio - 1 Year or Less	927,369	1,251,002	2,368,063	2,589,619
Total Current Assets	\$1,084,318	\$1,612,405	\$3,591,181	\$3,737,403
Long-Term Loan Portfolio	\$2,139,843	\$2,910,086	\$3,552,094	\$3,884,428
Less: Reserve for Bad Debts	74,232	99,088	111,277	129,530
Fixed Assets	195,365	368,500	428,112	470,537
Other Assets	33,298	25,894	59,782	58,390
Total Assets	\$3,378,592	\$4,817,797	\$7,519,893	\$8,021,227
Liabilities:				
Short-Term Loans	\$948,004	\$2,080,906	\$3,036,623	\$3,096,285
A/P and Other Short-Term Liabilities	91,218	124,594	181,575	188,282
Total Short-Term Liabilities	\$1,039,222	\$2,205,500	\$3,218,198	\$3,284,567
Long-Term Loans	\$683,752	\$761,045	\$1,943,623	\$2,141,457
Provisions	30,610	80,015	73,043	100,894
Total Liabilities	\$1,753,585	\$3,046,560	\$5,234,863	\$5,526,919
Capital:				
Capital from Donors:	\$922,333	\$879,160	\$1,096,361	\$1,155,683
- For the Loan Portfolio	922,333	879,160	1,096,361	1,155,683
Institutional Capital:	\$702,673	\$892,076	\$1,188,669	\$1,338,625
- Shareholder Capital	95,133	90,680	99,144	104,516
- Reserves	250,802	388,585	631,849	666,087
- Retained Earnings	225,694	326,069	361,248	380,908
- Net Period Earnings	131,043	86,743	96,428	187,115
Total Capital	\$1,625,006	\$1,771,237	\$2,285,030	\$2,494,308
Total Capital and Liabilities	\$3,378,592	\$4,817,797	\$7,519,893	\$8,021,227

Information Source: FIE's Accounting Management Report, March 1996

Exhibit 7
FIE'S LOAN PORTFOLIO EVOLUTION (in US dollars)

YEAR	NUMBER OF LOANS	AMOUNT DISBURSED	AVERAGE LOAN SIZE	CURRENT LOAN PORTFOLIO	NUMBER OF ACTIVE CLIENTS
1988	122	\$95,101	\$779.52	\$81,020	122
1989	615	412,052	670.00	304,973	655
1990	1,060	765,970	722.61	605,551	1,097
1991	2,248	1,843,815	820.20	1,409,364	2,350
1992	3,934	2,725,094	692.70	2,081,696	3,614
1993	5,740	4,400,293	766.60	3,107,539	5,358
1994	8,362	6,644,977	794.66	4,159,224	6,310
1995	15,965	9,862,112	617.73	5,881,046	10,994
1st Quarter 1996	5,356	3,137,140	585.72	6,249,794	12,090
Totals	43,402	\$29,886,554	\$688.60	N/A	N/A

Information Source: FIE's Credit Management Report, March 1996

Exhibit 8
FIE'S LOAN PORTFOLIO COMPOSITION PER REGIONAL OFFICE-VALUE OF LOANS (in US dollars)

REGIONAL OFFICE	PRODUCTION	CREDIT LINES			TOTALS	
		COMMERCE	ASSOCIATIONS	LEASING	US DOLLARS	PERCENTAGE
La Paz	\$2,042,625	\$367,261	\$272,821	\$100,257	\$2,782,964	44.53%
El Alto	1,264,931	220,360	-	81,941	1,567,232	25.08%
Santa Cruz	601,195	259,765	-	-	860,960	13.78%
Oruro	335,310	240,949	-	-	576,259	9.22%
Cochabamba	107,434	84,015	-	-	191,449	3.06%
Potosí	42,573	97,484	-	-	140,057	2.24%
Tarija	63,973	66,901	-	-	130,874	2.09%
Totals	\$4,458,041	\$1,336,735	\$272,821	\$182,198	\$6,249,795	N/A
Percentage	71.33%	21.39%	4.37%	2.92%	N/A	100.00%

Information Source: FIE's Credit Management Report, March 1996

Exhibit 9
FIE'S LOAN PORTFOLIO PER REGIONAL OFFICE - NUMBER OF LOANS

REGIONAL OFFICE	PRODUCTION	CREDIT LINES			TOTALS	
		COMMERCE	ASSOCIATIONS	LEASING	US DOLLARS	PERCENTAGE
La Paz	2,185	1,360	362	58	3,965	32.80%
El Alto	1,949	782	-	40	2,771	22.92%
Santa Cruz	1,098	824	-	-	1,922	15.90%
Oruro	612	642	-	-	1,254	10.37%
Cochabamba	420	436	-	-	856	7.08%
Potosí	208	484	-	-	692	5.72%
Tarija	270	360	-	-	630	5.21%
Totals	6,742	4,888	362	98	12,090	N/A
Percentage	55.77%	40.43%	2.99%	0.81%	N/A	100.00%

Information Source: FIE's Credit Management Report, March 1996

Exhibit 10
FIE'S LOAN PORTFOLIO IN ARREARS PER REGIONAL OFFICE (in US dollars)

REGIONAL OFFICE	1-10 DAYS	11-30 DAYS	31-60 DAYS	61-90 DAYS	91+ DAYS	TOTALS
La Paz	\$20,568	\$11,978	\$13,413	\$7,013	\$90,404	\$143,376
El Alto	23,553	10,745	3,370	2,552	23,696	63,916
Santa Cruz	8,435	6,900	6,017	1,819	18,400	41,571
Oruro	4,452	4,369	2,050	1,838	12,501	25,210
Cochabamba	3,246	753	1,001	348	2,767	8,115
Potosí	2,448	1,910	1,387	619	1,311	7,675
Tarija	1,978	4,447	1,765	1,429	508	10,127
Totals	\$64,680	\$41,102	\$29,003	\$15,618	\$149,587	\$299,990
Percentage	1.03%	0.66%	0.46%	0.25%	2.39%	4.80%

Information Source: FIE's Credit Management Report, March 1996

The Bolivian Economy³

For the Bolivian economy, 1995 was a year that fell short of expectations but saw the implementation of some important economic and social structure reforms. GDP growth and inflation failed to meet government targets, but Bolivia experienced positive economic growth for the ninth year in a row. That year's 3.8% GDP growth was higher than the average for Latin American countries, and inflation was still at historically low levels. The successful privatization of four state-owned enterprises attracted large pledges of new investment and began the realignment of Bolivia's productive sector toward a market orientation.

The government's budget increasingly reflected a commitment to social spending (though its management was now largely in the hands of departmental and municipal authorities), and moved away from support of state-owned companies. Bolivia's banking sector survived a difficult year (discussed further below), and despite some serious remaining problems, was expected to improve in the next year. Bolivia was still heavily in debt (76% of GDP), but remained solvent. Despite record exports, Bolivia's trade deficit widened in 1995. Increasing private sector participation in the hydrocarbons and mining sectors compensated for a decline in government investment in state-owned companies. Bolivia's vast informal economy, including some illegal smuggling, continued to rival the formal sector in size and importance.

In 1996 the government hoped to complete its most important economic reform—privatization—by selling Bolivia's largest company, YPFB, the state-owned oil and gas company. Successful completion of this reform was not guaranteed, but it would complete privatization of Bolivia's major productive sectors, as well as attracting investment that would stimulate growth in telecommunications, hydrocarbons, electricity, transportation and mining well into the next century.

Bolivia's Banking Sector⁴

Despite appearing at times on the verge of a major catastrophe, Bolivia's banking sector survived a 1995 crisis year and showed promise for improvement. Bank deposits (dominated by U.S. dollar deposits) and liquidity increased slightly, but interest rates remained high (over 16% for U.S. dollar denominated loans) and the number of delinquent loans almost doubled that year. Figures summarizing macroeconomic and banking sector indicators appear in Exhibit 14.

The failure in June of the Cayman Islands' branch of Bank Bolivian American (BBA-International) sent a shock through the system. Eventual losses to depositors were nearly US\$19 million. This collapse reinforced the

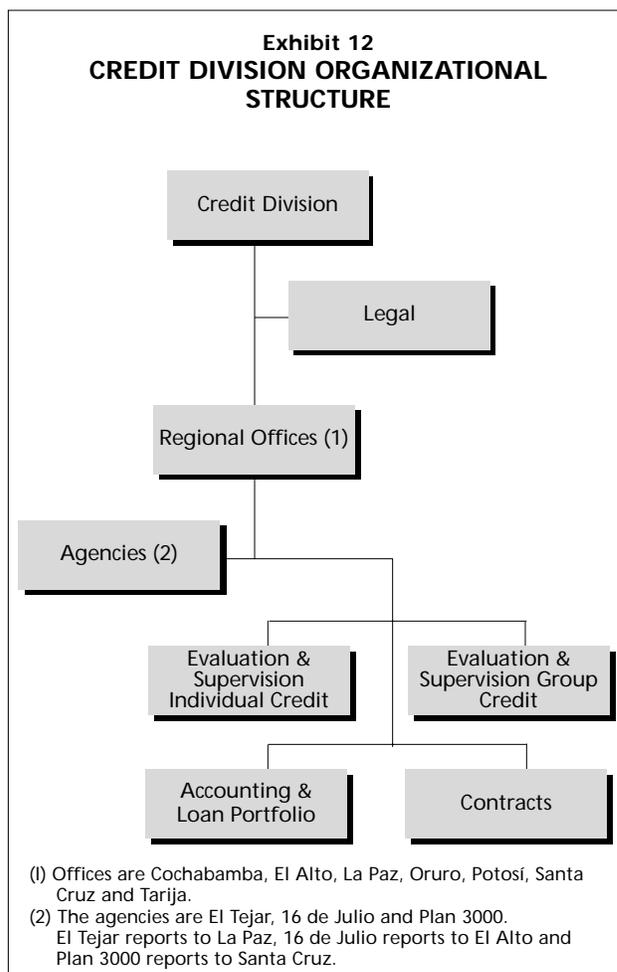
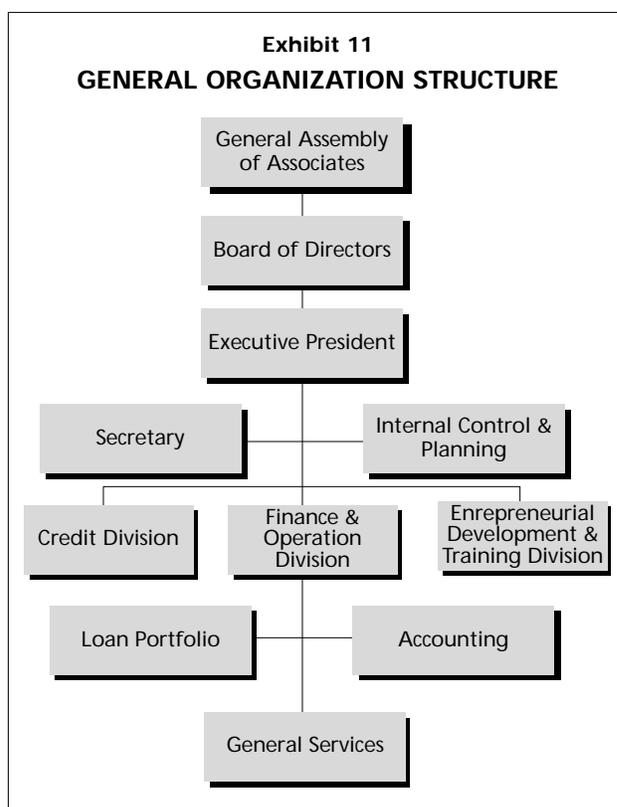


Exhibit 13
NUMBER OF EMPLOYEES

YEAR END	1993	1994	1995	1996 (1)
National Office				
Executive Staff	2	2	3	3
Accounting	3	3	1	2
Portfolio Computer System Staff	1	2	2	2
Legal Staff	2	1	2	2
Executive Assistant	-	1	1	1
Investment Adviser	-	1	-	-
Administrator	1	-	-	-
Support Staff	4	4	4	4
Totals	13	14	13	14
Credit Division				
Regional and Agency Directors	3	6	9	10
Evaluators	21	19	36	36
Collectors	2	2	1	1
Accountants	-	1	3	3
Cashiers	1	6	7	9
Support Staff	7	10	12	12
Totals	34	44	68	71

Note: (1) As of March 1996

Information Source: FIE's Credit Management Report, March 19960

public perception of a deteriorating banking system that began when two banks failed two years earlier (Bank Sur and Bank Cochabamba). Confidence dropped, deposits declined and BBA and three other banks were rumored to be struggling for survival.

Since mid-year, however, several events helped stabilize the banking sector. Three banks—BBA, Bank Unión and Bides—were purchased at least in part by foreign investors who promised large injections of capital. Another bank, BHN Multibanco, was soon to be capitalized by Citibank. The government created a bank support fund of more than US\$200 million to bolster capital-short banks. To qualify, banks had to submit acceptable proposals for better financial management. A new central bank law raised the capital/loan ratio requirement, banned new insider loans and required that existing insider loans be phased out over the next three years.

Confidence slowly returned, and by October banking deposits had stabilized. However, liquidity and deposits increased very little in the past year, insider lending continued to plague the system and loan defaults rose alarmingly. Interest rates remained high due to external factors and the Tequila effect (the devaluation of the

Mexican peso that affected other Latin American countries). Private business complained that the lack of funds in banks for new loans was stifling its capacity to invest and grow.

Although the banking sector was far from being a sufficient lending machine for the growth of Bolivia's private sector, the removal of several of its most troubled banks from life support had at least eliminated the possibility of imminent widespread collapse. As new capital from the government fund and private investors entered the system, greater liquidity and more lending was expected. It would still take time to create a healthier credit climate based on sound financial decisions, so in 1996 people still expected more loan defaults from past insider lending.

Bolivia's Microfinance Sector

Through their work with disadvantaged individuals and groups, some nongovernmental organizations (NGOs) identified limited access to financing as a major obstacle to economic progress. As a result, several NGOs began to develop microcredit programs as a way to offer disadvantaged populations the financial and non-financial services they needed.

The microfinance sector included microfinance credit programs administered by formal and semiformal financial institutions. The formal institutions supervised by the Superintendencia included two entities: Banco Solidario (**nicknamed Banco Sol**), a commercial bank that primarily assisted groups and Caja de Ahorro y Préstamos (the Savings and Loan Bank-Los Andes, S.A.), a Fondo Financiero Privado or FFP (Private Financial Fund) which assisted microentrepreneurs and small businesses with their working capital requirements. (FFPs are described further below.)

The semiformal financial institutions were the NGOs and other nonprofit institutions that offered credit programs in urban and semi-urban areas. They primarily served microentrepreneurs and small businesses and some served women exclusively. These included FIE and its primary competitors, including IDEPRO, or Instituto para el Desarrollo de la Pequeña Unidad Productiva (Small Productive Unit Development Institute); PRODEM, or Fundación para Promoción y Desarrollo de la MicroEmpresa (Foundation for the Microenterprise Development and Promotion); and FADES or Fundación para Alternativas de Desarrollo (Foundation for Development Alternatives). The size, growth and mix of loans from these institutions appear in Exhibits 15 and 16.

These institutions tailored their financial services to the needs of their clients and their own institutional requirements. Institutions serving microenterprises

charged interest rates generally higher than the prevailing ones established in the financial markets. This stemmed from the need to assure financial viability in the medium- and long-term and to match the market's prevailing conditions.

It is worthwhile noting that interest rates charged by the microfinance credit programs were the inverse of the conventional banking system, insofar as banks generally tried to reduce their rates for competitive purposes while NGOs increased their charges to gradually eliminate the implicit subsidies in their credit programs. In 1996, some microfinance interest rates amply surpassed the banking sector's effective interest rates, particularly in programs based on experimental methodologies previously used outside Bolivia. As Exhibit 17 shows, there was great similarity among the different NGO programs with regard to lending terms and required guarantees.

Bolivia's Superintendencia de Bancos

Several years earlier the Superintendencia had begun to investigate the possibility of expanding Bolivia's banking system. The banking system, as noted above, had been experiencing liquidity problems, specifically in attracting enough people to make deposits into the system. Several prominent national newspapers had reported that the banking sector was a sitting time bomb because it was rumored that there were only 60,000 deposits in the entire banking system. If these

Exhibit 14
BOLIVIAN MACROECONOMIC AND BANKING SECTOR INDICATORS

Indicators	1992	1993	1994	1995
Gross Domestic Product (2,4)	1.70%	4.00%	4.20%	3.80%
Inflation Rates (3)	10.46%	9.31%	8.52%	12.58%
Year End Exchange Rate (E)	Bs. 4.10	Bs. 4.48	Bs. 4.70	Bs. 4.94
Accumulated Annual Devaluation (2)	9.33%	9.27%	4.91%	5.11%
Total Banking System Deposits (3)	\$ 1,544.80	\$ 2,052.70	\$ 2,167.40	\$ 2,401.80 (1)
Change by Year	23.40%	32.90%	5.60%	10.80% (1)
Deposits in Foreign Denominations (2)	84.20%	81.80%	79.80%	82.30% (1)
Banking Liquidity (3)	\$ 367.10	\$ 552.20	\$ 554.10	\$ 606.30 (1)
Change By Year (2)	47.70%	50.40%	0.30%	9.40% (1)
Year End Loan Interest Rates:				
US dollars (2)	17.43%	16.36%	15.15%	18.35%
Bolivianos (2)	43.73%	43.53%	40.18%	30.09%
Year End Term Deposit Interest Rates:				
US dollars (2)	11.17%	9.83%	9.25%	10.55%
Bolivianos (2)	21.78%	18.40%	14.81%	16.36%
Delinquent Loans (3)	\$ 121.60	\$ 149.00	\$ 91.80	\$ 173.80
Change by Year (2)	7.80%	22.50%	-38.40%	89.30%
Delinquent Loans/Portfolio (2)	6.60%	6.30%	3.70%	6.20%

Notes: (E) Sale of Bolivianos, (1) Estimation, (2) In percentage, (3) In millions of US dollars, (4) Annual variation

Exhibit 15
LOAN PORTFOLIO EVOLUTION PER INSTITUTION (in US dollars)

LOAN PORTFOLIO				
INSTITUTION	1994	1995	ACCUMULATED USERS	CURRENT USERS
BANCO SOL	\$33,214,457	\$36,857,090	432,982	63,038
FIE	4,159,225	6,118,654	38,046	10,994
LOS ANDES	2,863,000	5,953,000	63,303	13,849
IDEPRO	1,494,612	2,160,416	13,946	7,494
CIDRE	653,753	638,883	933	329
PROA	873,108	1,114,732	1,255	417
FUNBODEM	214,265	420,435	1,249	421
PRODEM	2,615,812	4,516,521	18,309	-
FADES	3,068,395	4,555,080	26,620	-
SARTAWI	1,214,361	1,274,973	5,566	-
ANAPRI	N/A	1,589,297	3,933	99,644
TOTALS	\$43,472,420	\$65,199,081	555,647	196,186

Information Source: CIPAME, 1995

Exhibit 16
LOAN PORTFOLIO PER INSTITUTION (in US dollars)

LOAN PORTFOLIO						
INSTITUTION	ACCUMULATED DISBURSEMENTS	GROSS	CURRENT	PAYABLE	EXECUTED	ARREARS
BANCO SOL	\$230,520,030	\$36,857,090	\$35,725,077	\$612,230	\$519,783	\$1,132,013
FIE	26,749,414	5,881,046	5,643,438	237,608	-	237,508
LOS ANDES	31,718,000	5,953,000	5,649,792	297,500	5,708	303,208
IDEPRO	12,872,803	2,160,416	2,012,640	128,101	19,675	147,776
CIDRE	2,437,856	638,883	625,900	9,247	3,736	12,983
PROA	3,292,505	1,114,732	1,101,992	11,902	838	12,740
FUNBODEM	627,080	420,435	408,265	5,949	6,221	12,170
PRODEM	N/A	4,516,521	4,512,952	1,380	2,513	-
FADES	N/A	4,555,080	4,157,808	146,186	251,086	-
SARTAWI	N/A	1,274,973	1,216,792	32,264	25,917	-
ANAPRI	2,580,672	1,589,297	1,255,843	207,067	126,387	333,454
TOTALS	\$310,798,360	\$64,961,473	\$62,310,499	\$1,689,434	\$961,864	\$2,191,852

Information Source: CIPAME and FINRURAL, 1995

Exhibit 17
PRODUCTS AND FINANCING TERMS PER INSTITUTION

Micro-Finance Programs	Nominal Interest Rate(1)	Average Loan Amount	Average Period (months)	Amortization (2)	Guarantees (3)
BANCO					
Local Currency	48.0% LC	\$ 270	5.0	W,F	6
- With value Maintenance	30.0% FC	365	12.0	W,F,M	6
FIE					
- Commerce	36.0% LC	\$ 424	2.5	W,F,M	1
- Production	24.0% FC	930	12.4	M	1,3,4,5
- Leasing	22.0% FC	1,900	24.0	M	2,7
LOS ANDES					
- Production	36% LC	\$ 515	7.0	F,M	1,2,4
- Commerce	42.0% LC	515	7.0	W,F,M	1,2
IDEPRO					
- Small Business	21.0% FC	\$ 190	3.0	W,F,M	6
- Development Credit	21.0% FC	2,000	16.0	M	1,4,7
- Associate Credit	21.0% FC	365	5.0	W,F,M	5,6
CIDRE	16.0% FC	\$ 2,476	21.0	M	1.4
PROA	21.0% FC	\$ 1,200	12.0	M	1
FUNBODEM	16.0% FC	\$ 1,300	-	M	1,2
ANAPRI	N/A	N/A	N/A	N/A	N/A

1) Annual nominal interest rates: LC=Loans in local currency, FC=Loans in foreign currency or with a clause of value maintenance.

2) Amortization period: W=Weekly, F=Fortnightly, M=Monthly.

3) Indicated in order of priority, is the type of guarantee most frequently utilized by each program: 1=Personal, 2=Collateral, 3=Telephone Line, 4=Mortgage, 5=Guarantee Fund, 6=Solidary group, 7=Personal pledge.

Information Source: CASANOVAS, R;op.cit.

depositors withdrew their monies, many feared the entire system would collapse.

The Superintendencia had been observing with interest the growth of the new microfinance sector, trying to determine how the organizations in this sector could possibly alleviate the liquidity problems of the banking sector. One proposal was to have microfinance institutions encourage their customers to deposit money in the private banking system. The banking sector usually did not serve this population, since the poor were unable to provide normal guarantees, such as collateral for financial services. In return, the Superintendencia thought that it might be able to provide microfinance organizations with potential access to the Central Bank's funds to alleviate their liquidity problems.

Thus, with the assistance of the U.S. Agency for International Development (USAID), which was looking to assist the microfinance sector, the Superintendencia approved a new strategy that created a new class of

financial institution within the banking sector, namely El Fondo Financiero Privado (FFP). The FFP was to be a financial entity in between a nonprofit organization and a bank, potentially bridging the large gap between the two. Banks normally shunned microentrepreneurs, while nonprofit microfinance institutions were unable to offer services beyond small loans.

The FFP would be able to offer savings instruments as part of its financial services package, which nonprofits were prohibited from offering. The FFP could offer savings in two basic forms: short-term savings deposits and longer-term certificate of deposits. More importantly, the FFP would have access to the Central Bank's funds and be able to borrow up to 12.5 times its net worth. Furthermore, the FFP would not be regulated by the same set of rigid standards that applied to the country's banks. Rather, there would be a new set of standards that would strengthen the financial and operational standing of member organizations. The main limitation for a FFP would be that it could not offer checking

account services or perform international transactions as banks do.

For nonprofit organizations, this move by the Superintendencia was seen as a huge step towards alleviating the liquidity problems plaguing the microfinance sector. Under this charter, the stronger microcredit programs would be able to meet the ever-increasing demands of their clients.

The Executive Question Revisited

During its first ten years, FIE had experienced extraordinary growth. This growth enabled the credit program to reach a significant industry milestone of financial self-sustainment (the ability to self-finance) much earlier than anticipated. There were basically two levels of self-sustainment. The first was operational self-sustainment, meaning that FIE generated sufficient operating income to cover its operating expenses, but not its financial expenses. The second and higher level was financial self-sustainment, meaning that FIE generated sufficient operating income to cover both its operational and financial expenses. Recent growth suggested that demand for microfinance services would not decline anytime soon, so institutions targeted financial self-sustainment as a desirable and achievable way to operate in Bolivia.

But as in any growing institution, FIE was still feeling the strain and effects of limited resources. This appeared dramatically in its inability to meet current client demands in a timely fashion. (During November-December, a loan disbursement could take up to 60 days.) It also limited its plans to expand into new semi-urban areas and to open the two new agencies in La Paz and El Alto, given that existing offices were operating at capacity. As more IDOs considered FIE an institution with considerable experience and expertise in its specialty area, IDO donations and low-interest loans shrunk. The IDOs generally provided FIE with financial and technical assistance only for the programs requiring consolidation and new programs under development (especially women's programs). As a result, IDOs expected FIE to make notable steps towards financial self-sustainment over the term of their support. Their goal was to provide funding to permit FIE to improve its operations and strengthen its loan portfolio so that it could broaden its funding opportunities by borrowing from other financial entities, such as banks.

To further complicate matters, current and potential creditors were demanding that FIE implement stricter reporting guidelines and more reliable internal controls. Over the years, FIE had dedicated a significant amount of its financial and human resources to the development and growth of its credit program. However, this had come at the expense of developing

its accounting and financial operations systems. This resulted in two almost completely incompatible systems that could hardly communicate with one another. Thus, FIE seemed to have an unwanted reputation for being notoriously late in submitting financial statements and progress reports to its creditors, perhaps discouraging their additional funding. It could not meet specified deadlines due to its poorly managed operations system. It took on average 90 days for the head accountant to close the various accounting ledgers and prepare a draft of the financial results for review by the executive staff. Final approval would then take a few more weeks to allow time for routine adjustments.

Complicating the situation was FIE's approach towards work. It routinely faced crises instead of planning its future. For example, FIE tended to fulfill creditor requests for information or reports at the last possible moment. At present there were no controls in place to remind the staff of creditor deadlines. Usually a staff employee or the credit manager would recall that a creditor request must be completed in the next few days. FIE's creditors were beginning to demand that FIE implement immediate corrective actions. This surely had bearing on FIE's ability to secure financial resources for the future.

FIE was also experiencing an unexpected side effect from its employee recruitment program. As the institution had grown in size, it had hired new employees without ever specifying recruiting guidelines. FIE regularly hired university students in the midst of their college programs to attract inexpensive talent with no specific education or background experience. FIE believed it could train its employees to learn the FIE way, regardless of their education or experience. What they had not realized was that this effort to minimize salary expenses meant that FIE now lacked employees with banking experience or financial education common to banks and required by the Superintendencia.

Yet over these same years, this lack of a banking atmosphere at FIE helped create a rather informal and friendly work climate. A strong family orientation was present in FIE's company culture and this helped foster an enormous amount of friendship and respect among the majority of coworkers. Routinely a group of between 5 and 30 employees went out drinking and singing together at the end of the week. These friendships were the basis for the strong sense of trust that dominated the organization.

FIE's Annual Executive Staff and Director's Meeting

The time had arrived for the regional office and agency directors to convene at FIE's national office in La Paz with the executive staff for the annual director's meeting.

Exhibit 18
CREDIT PROGRAM 1995 YEAR-END RESULTS AND REVIEW (in US Dollars)

DETAIL	GOALS PROPOSED		RESULTS ACHIEVED		PERCENTAGE VARIATION	AMOUNT DISBURSED
	NUMBER OF LOAN	AMOUNT TO DISBURSE	NUMBER OF LOANS	AMOUNT DISBURSED		
Regional Office La Paz						
- Production	1,600	\$2,080,000	1,082	\$1,279,709	-32.4%	-38.5%
- Commerce	2,500	1,125,000	2,599	1,265,405	4.0%	12.5%
- Associations	375	506,250	238	290,200	-36.5%	-42.7%
- Leasing	90	225,000	21	54,856	-76.7%	-75.6%
Agency El Tejar						
- Production	600	780,000	715	812,438	19.2%	4.2%
- Commerce	700	280,000	744	296,750	6.3%	6.0%
- Leasing	24	36,000	25	47,429	4.2%	31.7%
Total Region La Paz	5,889	\$5,032,250	5,424	\$4,046,787	-7.9%	-19.6%
Regional Office El Alto						
- Production	1,500	\$1,350,000	1,172	\$1,064,170	-21.9%	-21.2%
- Commerce	800	200,000	852	316,080	6.5%	58.0%
- Leasing	36	90,000	13	29,420	-63.9%	-67.3%
Agency 16 de Julio						
- Production	600	450,000	681	559,066	13.5%	24.2%
- Commerce	800	200,000	575	233,541	-28.1%	16.8%
- Leasing	12	18,000	5	14,950	-58.3%	-16.9%
Total Region El Alto	3,748	\$2,308,000	3,298	\$2,217,227	-12.0%	-3.9%
Regional Office Oruro						
- Production	300	\$240,000	599	\$431,188	99.7%	79.7%
- Commerce	1,200	480,000	1,334	651,832	11.2%	35.8%
Total Region Oruro	1,500	\$720,000	1,933	\$1,083,020	28.9%	50.4%
Regional Office Santa Cruz						
- Production	750	\$750,000	619	\$667,622	-17.5%	-11.0%
- Commerce	500	400,000	669	554,227	33.8%	38.6%
Agency Plan 3000 (1)						
- Production	-	-	494	186,815	N/A	N/A
- Commerce	-	-	571	182,467	N/A	N/A
Total Region Santa Cruz	1,250	\$1,150,000	2,353	\$1,591,131	88.2%	38.4%
Regional Office Cochabamba						
- Production	400	\$320,000	517	\$238,724	29.3%	-25.4%
- Commerce	600	240,000	967	280,012	61.2%	16.7%
Total Region Cochabamba	1,000	\$560,000	1,484	\$518,736	48.4%	-7.4%
Regional Office Potosí (1)						
- Production	-	\$-	196	\$57,780	N/A	N/A
- Commerce	-	-	764	197,711	N/A	N/A
Total Region Potosí	-	\$-	960	\$255,491	N/A	N/A
Regional Office Tarija (1)						
- Production	-	\$-	181	\$54,577	N/A	N/A
- Commerce	-	-	332	95,142	N/A	N/A
Total Region Tarija	-	\$-	513	\$149,719	N/A	N/A
Total Credit Program	13,387	\$9,770,250	15,965	\$9,862,111	19.3%	0.9%

Note (1): Agency Plan 3000, Regional Office Potosí, and Regional Office Tarija initiated operations in the 2nd and 3rd quarters of 1995.

The annual meeting generally provided the management staff with an opportunity to review the credit program's previous year's performance by (1) analyzing the program's accomplishments and shortcomings, (2) recommending appropriate changes and modifications to the program and (3) approving next year's goals and objectives for the Credit Division. However, it also provided the executive staff with an opportunity to announce or discuss pressing organizational issues. Enrique already knew that there was more on the agenda for this year's annual meeting than just approving next year's program goals and objectives. The meeting would begin the process of determining FIE's long-term strategy for growth and stability.

It was now 10:00 a.m., although the meeting had been scheduled for 9:00.⁵ Enrique's secretary came to advise him that all the directors had finally arrived and they were now ready to begin the meeting. Rising to join them, Enrique paused for a brief moment to appreciate the special decorations that now hung in his office as part of current holiday festivities. It was Carnival season, and this meant it was time to *challar* everything he owned to request good luck for the coming year. *Challar*—a word in the Amayra language, a dialect widely spoken in Bolivia—meant to ask Mother Earth to watch over and protect worldly possessions and bring good luck in the coming year. As he *challared* the items in his office, Enrique thought the coming year would have special meaning for him and all of FIE associates and clients. The organization definitely needed good luck if it was to transform itself to better serve its clients, the microentrepreneurs and small businesses of Bolivia.

After talking informally for some time, discussing family, friends, local news, even the results of recent World Cup qualifying soccer games, the meeting finally came to order. "Good morning to everyone. I am happy to see you have all arrived safely," Enrique began. "I would like to begin this year's annual meeting with a review of the credit program's year-end results (Exhibit 18)." As the directors pulled out their handout, Jenny knocked on the door, walked into the meeting room, handed Enrique an envelope and whispered, "This memo just arrived from USAID. The messenger indicated that it was urgent and that I should deliver it to you as soon as possible." After thanking her, Enrique opened the envelope to find inside an urgent memo from USAID (Exhibit 19) calling upon FIE to "clean up its act" administratively or face an imminent, severe funding cutback.

Enrique again addressed the directors. "It appears that I have a bit of distressing news. As most of you should know, USAID recently finished conducting an audit of our accounting and operational systems. I now have the audit results that USAID just sent me and they are not very promising. USAID expects FIE to make certain improvements in its systems or else risk having our

funding frozen by USAID." Though uncomfortable with this news, Enrique immediately realized that this blunt feedback created an ideal opportunity to begin discussing the organizational issues he had been pondering regarding FIE's future.

"FIE has enjoyed a lot of success during its first ten years of operation," said Enrique. "Beginning as a local player, FIE is now a national provider of credit to Bolivia's major urban areas. However, FIE is now at an important juncture in its history where a change may be needed to meet the new challenges and problems we face, such as indicated by this USAID memo. The problems they mention here we have known about for some time, but now we must finally address them."

Enrique paused for a moment, then continued. "Although FIE has achieved its year-end goals, two offices actually experienced a decrease and were unable to achieve their goals. If FIE is to continue to move forward, I strongly believe that now is the time for us to discuss our thoughts about how FIE should position itself as a major player in the future of the microfinance industry." In Enrique's mind, there was nowhere to go except towards additional growth.

A temporary silence came over the meeting as the directors absorbed what Enrique had just announced. The first person to speak was Oscar Vedia, director of the regional office La Paz. Oscar had been with FIE for more than six years, first working as a loan evaluator. When the La Paz regional office was opened, the credit manager personally selected Oscar to assume the director's position. Oscar was considered one of the better directors within FIE, but he had no formal training in business, as he had studied electrical engineering. Oscar addressed Enrique respectfully, as all employees addressed their superiors: "Licenciado,⁶ with regard to your call for suggestions, I would like to voice my opinions regarding the future path FIE should be undertaking. As we all are aware, FIE has been developing some pretty severe liquidity problems, which have critically affected the regional office under my supervision. Due to the growth, many of the funds that were originally to be utilized here were diverted to other offices like Potosí and Tarija to get them up and running," a fact that had quite frustrated him earlier in the year. "As a result, my office has been put at a disadvantage and we were unable to meet our goals set by the credit manager."

Oscar continued, "I have been here for over six years now and seen the incredible growth of FIE and the entire credit industry. I see a lot of potential for our future, but we need to seriously address our liquidity problems. We have already seen one member of the industry become what FIE should become. It is Banco Sol, one of our competitors. Banco Sol transformed itself from a nonprofit institution into a regulated

CASE STUDIES



*Staff members
of the Potosí
Regional
Office*



*FIE's main office
building in the city
of La Paz*

bank. (It was previously affiliated with PRODEM. PRODEM tended to rural areas, while Banco Sol concentrated on more urban areas.) We can now see the success they have seen: they now have over \$36 million in their loan portfolio and currently over 63,000 users of their financial services. Certainly they have experienced problems as any growing organization would, but the advantages most certainly outweigh the costs and risks. They now have access to the Central Bank's funds, which we most certainly could use. Now that Banco Sol is regulated by the Superintendencia, it has given them greater credibility with its current and future creditors. That is the future path for FIE, especially if FIE wants to be a leader in the industry and set the standards versus playing follow the leader."

Roxana Nava, director of the regional office Santa Cruz, then added her opinions. She had been with FIE for more than five years and was also a member of FIE's general assembly. She had significant business education and training, and she helped FIE develop its accounting and loan portfolio systems. She was also one of three sisters working at FIE. Roxana supervised one of her sisters, Maria del Carmen Nava de Pereira (the director of the agency "Plan 3000"), and the third, the credit division manager, supervised both of them. "*Licenciado Enrique and my fellow directors, I would also like to offer my thoughts regarding FIE's future path in the credit industry. We have all seen the dramatic increase in the number of organizations offering services in the credit industry and, fortunately, FIE has been among the leaders. FIE must change so that FIE can continue to meet its clients' demands and eliminate the long waits for disbursements from new credit applications that sometimes results from our lack of funds.*

But I am not sure I agree with my colleague that transforming into a bank is the correct path for FIE."

She continued, "Yes, there are certain benefits that come with such a transformation, as Oscar has pointed out, but would FIE actually be ready and able to function as a bank? I am not so sure. Most of the employees do not have direct experience or training to work as a bank. FIE may be stepping out of bounds by taking on such a huge transformation. Furthermore, would we be able to uphold FIE's original vision, or would the Superintendencia's rigid control prevent FIE from serving those whom FIE first intended to serve, the disadvantaged urban sectors of Bolivia? I believe that we should pursue the new FFP financial entity that the Superintendencia approved recently. This would give FIE many of the advantages of a bank, but we would still be exempt from certain banking regulations. What's more important, one of our principal competitors, Los Andes, has already been approved as a FFP, and it is ready to surpass FIE in its loan portfolio size. This is definitely a cause for concern." Los Andes had been founded by a former member of FIE who had left to start his own nonprofit institution, and it now competed for financial support from the same IDOs. To many in the room, it was a matter of personal pride how FIE fared relative to Los Andes.

One of the directors in attendance, Maria Rojas de Schulze of the regional office El Alto, was also one of FIE's original founders and a member of its board of directors. She did not have any direct experience in banking or business other than her ten years with FIE, where she basically learned the business from the ground up. But she had a strong desire to make the vision of FIE a reality in all the urban and rural sectors

of Bolivia. She also had a special position in FIE and could push her ideas through the chain of command due her status as one of its founders.

As soon as Roxana finished, Maria jumped in, "My fellow colleagues, I do admire your desire to continue the growth and success of FIE, but I must say that I am a bit concerned about the measures you are suggesting. You must remember that I helped found this institution on the premise that FIE would serve those people who were shut off from the formal banking sector. It has been this desire that has enabled us to grow so successfully over the last decade. I fear that if FIE were to pursue the other options mentioned, FIE would forget about those whom I want to help. FIE would become just like the other formal financial institutions and measure everything based on the bottom line. I strongly recommend that FIE remain as it is, so as not to alienate its clientele. We have come this far as a nonprofit institution and achieved much success, so I do not see any reason why we cannot continue as we are, enjoying the success we have had and further realizing the dream that I first had ten years ago."

The director said, "I thank you very much for your comments. It appears that FIE has some distinct viable options to position itself for the future. I would like to recommend that we nominate a team to research the various options and return with a recommendation one month hence."

FIE's Future Path

FIE now faced a tough strategic decision regarding its institutional future. Possibly a major change was needed to ready FIE for its second decade as a continued leader in the microcredit lending industry. If FIE wished to continue growing in servicing the demands of its

clients, it would have to search out new funding sources to help resolve its liquidity problems. What is more, it would have to assess the attractiveness of emerging opportunities (such as FFP status) and ready itself to face coming threats (such as the banks' possible entry into the microfinance industry). If the banks did enter the microcredit business, would the Superintendencia begin to regulate the industry by imposing stricter guidelines? As a nonprofit institution, FIE had heretofore enjoyed exemption from current banking and government regulations.

A few options seemed clear for the future of FIE. It could continue to operate as a nonprofit institution as it had for the last decade, and compete with other nonprofit organizations for low-interest financial resources from the IDOs. However, these financial resources were becoming less available to FIE as more and more institutions competed for them. This was in part attributable to FIE's paving the way for other nonprofit organizations to start credit programs in La Paz and other Bolivian cities, and perhaps was also attributable to FIE's lax discipline in dealing with the IDOs. Even if FIE remained a nonprofit, it still had to strengthen internal financial controls and eliminate liquidity problems. The cleanup of administrative systems and procedures for internal control and coordination was a long awaited improvement, yet it eventually took the external pressure from aid agencies to force management to attend to these matters.

FIE could transform itself into a bank and acquire the advantages of operating as a formal financial institution, such as offering new financial services like saving and checking accounts, loans and other international services. However, to become a bank, FIE would have to undergo a notable reorganization and dramatically improve its financial operations to comply with stricter

Traditional challar ceremony requesting blessings for the coming year



Dancing "the Morenada" during Bolivia's carnival in the city of Oruro

Exhibit 19
USAID/BOLIVIA MEMORANDUM

UNITED STATES GOVERNMENT

memorandum

CONT-96/0224

February 24, 1996

Reply to: Denise Fernandez, Financial Analyst, USAID
 Subject: Institutional Revision of the Center for the Development of Economic Initiatives (FIE)
 Reference: The Microenterprise and Small Business Development Project 511-059x
 To: Enrique Soruco, Executive President, FIE
 Through: Richard J. Goughnour, Country Director, USAID

After a complete revision of FIE's accounting and credit systems, I am recommending that USAID/Bolivia conditionally continue to grant new financial resources for FIE's Credit Program. This condition will be removed once FIE has demonstrated that it has improved its financial internal controls and operations procedures to properly manage the assigned funds. The following list details the deficiencies I observed in FIE's operations and systems:

Organizational Structure - Adjust the organizational chart to accurately reflect the existing positions within FIE.

Manuals - Create a Manual of Employee Functions to reflect the characteristics of the adjusted organizational chart. Revise the administrative and financial practices of the Credit Division to achieve an adequate control of its operations. Create a Manual of Personnel Administration that clearly indicates the prevailing procedures of the institution.

Personnel - The National Office should exercise greater control over the hiring of personnel for the Regional Offices and Agencies. Complete the personnel files so that they may be effectively used for employee evaluations and promotions.

Accounting System and Internal Control - Evaluate the functions realized by the Regional Offices to ensure adequate norms and internal control. Consolidate the accounting and loan portfolio systems so that they are available and accessible to the entire organization.

Budgets and Control - Implement budgets for all of FIE's Divisions to facilitate implementation and evaluation. Design and implement an adequate budget control that responds to FIE's needs and improves the control of financial resources.

Periodic Reports - FIE should adequately file its monthly and quarterly reports for future institutional revisions.

Inventory Control - Make a complete list of all the equipment and furniture under FIE's custody, clearly identified with its code.

I consider these deficiencies to be the priorities that FIE needs to resolve before any further funds are disbursed to the institution. By April 1, I will return to FIE to evaluate the progress on the improvements. If FIE has not satisfactorily completed the above revisions, I will recommend that USAID/Bolivia freeze any further disbursements of funds to FIE.

banking regulations and guidelines. Certain in-house issues must be examined and resolved, including: (a) building operational systems to strengthen internal financial controls, (b) reducing or eliminating liquidity problems to satisfy client demands promptly, (c) finding needed training programs to teach its personnel banking procedures and (d) combining its organizational culture with the Superintendencia's rigid control without losing sight of FIE's vision and objective. In addition, FIE must begin (e) offering high quality products and services in an increasingly competitive market where the competition continuously grows and develops new services that better satisfy client expectations and (f) profitably combining a new financial savings product with

its Credit Program. There were legitimate questions regarding whether or not an organization can successfully undergo or "stomach" so much change.

Finally, FIE could venture down the new path offered by the Superintendencia—to become an FFP. This option seemed promising, as it would allow FIE to offer saving products which could attract new funds for its Credit Program. Most importantly, FIE would gain access to the Central Bank's funds for future lending to clients. However, there was not enough information available to see how viable this option would be, whether or not the Superintendencia would actively promote it and whether the banks could block its rollout. Several non-profit institutions were already taking necessary steps

A evaluator from El Alto considering a loan application from a woman seeking a commerce credit line



to apply for the FFP license. Perhaps it would be better for FIE to wait to see if they were successful, then FIE could proceed later.

But Enrique knew FIE could not afford to wait and watch. Time was no longer a luxury; the future had arrived and it was time to take action now to move FIE into what Enrique hoped would be its second successful decade as a leader in the microcredit lending industry. He had to consider carefully the people and culture of FIE to judge the whether they had the ability, willingness and commitment to undergo serious organizational change.

NOTES

1. This case was written by Michael Aguilera of the University of Washington. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Special thanks to Professor Pamela Posey of the University of Washington and Professor Richard Linowes of American University for their help and guidance in the development of this case.
2. Alto Comisionado de Naciones Unidas para Refugiados (ACNUR).
3. Source of Information: Bolivian Economy Report, American Embassy Bolivia, 1996.
4. Ibid.
5. Culturally, it is rare to begin a meeting on time.
6. *Licenciado* was originally a term used to show respect to a person who had completed a formal program of education at a university level. Informally, it has become customary to use the title as a general sign of respect to any other person of higher rank, such as a supervisor or manager.