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**BOLIVIA**

**FINANCIAL SECTOR NOTES**

ASSESSING THE SECTOR’S POTENTIAL ROLE IN FOSTERING RURAL DEVELOPMENT AND GROWTH OF THE PRODUCTIVE SECTORS

DECEMBER 2011

|  |  |
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| THE WORLD BANK |  |
| FINANCIAL AND PRIVATE SECTOR DEVELOPMENT VICE PRESIDENCY  LATIN AMERICA AND CARIBBEAN REGIONAL VICE PRESIDENCY |  |

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**Abbreviations and acronyms**

|  |  |
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| ACCL | *Administración De Cámaras de Compensación Y Liquidación* |
| AML-CFT | Anti-Money Laundering and Combating the Financing of Terrorism |
| ANED | *Asociación Nacional Ecuménica de Desarrollo* |
| ASFI | *Autoridad de Supervisión del Sistema Financiero* |
| ASOBAN | *Asociación de Bancos Privados de Bolivia* |
| ASOFIN | *Asociación de Entidades Financieras Especializadas en Micro Finanzas de Bolivia* |
| ATM | Automated Teller Machine |
| BCP | Basel Core Principles |
| BDP | *Banco de Desarrollo Productivo* |
| CAC | *Cooperativas de Ahorro y Crédito* |
| CB | Central Bank |
| CCT | Conditional Cash Transfer |
| CEMLA | *Centro de Estudios Monetarios Latinoamericanos* |
| CGAP | Consultative Group to Assist the Poor |
| DEG | *Derechos Especiales de Giro* |
| EBT | Electronic Benefit Transfer |
| ESW | Economic Sector Work |
| FDP | *Fideicomiso para el Desarrollo Productivo* |
| FFP | *Fondos Financieros Privados (Finance Companies)* |
| FINRURAL | *Federación Nacional de Instituciones Financieras de Desarrollo* |
| FOMIN | *Fondo Multilateral de Inversiones (Grupo BID)* |
| FSAP | Financial Sector Assessment Program |
| FUNDEMPRESA | *Fundación para el Desarrollo Empresarial* |
| FX | Foreign Currency |
| GDP | Gross Domestic Product |
| GNI | Gross National Income |
| IADB | Inter-American Development Bank |
| ICT | Information and Communications Technology |
| IFC | International Finance Corporation (World Bank Group) |
| IFD | *Instituciones Financieras para el Desarrollo Rural* |
| IMF | International Monetary Fund |
| INE | *Instituto Nacional de Estadística de Bolivia* |
| MFI | Microfinance Institutions |
| MIX | Microfinance Information Exchange |
| MSME | Micro, Small and Medium Enterprises |
| NGO | Non-Governmental Organization |
| NIT | *Número de Identificación Tributaria* |
| NPL | Non-performing loan |
| PACPUCS | *Programa de Apoyo Crediticio a Pequeñas Unidades de Comercio y Servicio* |
| PND | *Plan Nacional de Desarrollo* (National Development Plan) |
| POS | Point of Sale |
| PROFIN | *Fundación para el Desarrollo Productivo y Financiero* |
| ROA | Return on Assets |
| ROSC | Report on the Observance of Standards and Codes |
| ROE | Return on Equity |
| RTGS | Real-Time Gross Settlement |
| SARC | *Servicio de Atención de Reclamos de los Clientes* (Customer Support) |
| SLA | Savings and Loans Associations (*Mutuales)* |
| WOCCU | World Council of Credit Unions |

**Currency Equivalents**

Exchange Rate Effective May 1, 2011

Currency Unit = Bolivian Boliviano (Bs.)

USD 1.00 = Bs. 6.99

**Government Fiscal Year**

January 1 – December 31

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**Acknowledgements**

Task team leader for this report was Juan Buchenau, with Ilka Funke as co-task team leader and main author, and Karina Baba (all three LCSPF) providing valuable research support. Mission travel and research for this report were carried out between February 2010 and April 2011. Information on the developments in the regulatory framework thereafter and until November 2011 were incorporated mostly in the form of footnotes. The report benefited from (i) a background note prepared by Jose Antonio Sivilá Peñaranda (Consultant, Bolivia) on the evolution of the financial system, (ii) a technical note prepared by Alvaro Duran (Copenae, Costa Rica), Ronald Arze (Assist, Bolivia) and Ilka Funke on the transition of closed cooperatives into the regulatory sphere, which included an in-depth assessment of the applicable regulatory framework, and (iii) an assessment of the credit bureau infrastructure by the WHCRI initiative - all of which were fully or partially funded through this ESW. Furthermore, the report also benefitted from earlier World Bank reports on strategic alliances in urban areas, partial credit guarantee schemes and the level of informality in the Bolivian economy. Juan Buchenau and Ilka Funke also participated in the recent FSAP update[[1]](#footnote-1).

During the missions staffed for this report, the team met with the Minister for Development Planning, the Vice-minister for Pensions and Financial Services, the Central Bank Governor, the Executive Director of the Financial System's Authority, their respective senior staff, and representatives of banks, specialized credit entities, as well as representatives of the non-financial private sector. The team would like to express its gratitude to the government and private sector stakeholders for their time and valuable input, and in particular to the Ministry of Economy and Finance and ASFI for their excellent support throughout this analysis and for their comments on the report.. The opinions presented in this report are only attributable to the authors as are any errors and omissions.

The team would also like to thank Lily Chu, Carlos Silva-Jauregui, Oscar Avalle, Julio Loayza and Mike Goldberg for their guidance and support. Peer reviewers were Aquifers Almansi (FPDDO), Luisa Zanforlin (IMF), Julio Loayza (LCSPE) and Xavier Faz (CGP). The team also wishes to thank Gaston Blanco (LCSHS), David Tuchschneider (LCSAR), Eva Gutierrez and Jane Hwang (both LCSPF) for their input into selected topics, Monica Rivero (LSCPF) for her excellent support throughout the year, Eric Palladini (LCSPF) for editing the document, and Patricia Velasco, Kelly Keirnan and Ximena Resnikowski for the invaluable support provided during the missions.

**The financial sector in Bolivia – Assessing the sector’s potential role in fostering rural development and growth of the productive sectors[[2]](#footnote-2)**

# Executive Summary

Bolivia benefited from an overall favorable economic evolution in the last few years, supported by sound macro-economic indicators. Yet, economic growth was unevenly distributed between the sectors, with particularly extractive industries, construction and financial services showing higher real growth rates, while agriculture and manufacturing fell behind. This is an area of concern for the government which – as manifested in the new Constitution - aims to foster a more balanced and equitable growth. In its reform measures, it places a particular focus on developing the rural areas, in which a large share of the indigenous population lives, and on the productive sector (agriculture, forestry, manufacturing and extractive), which provides the livelihood for a substantial number of poor people.

This paper aims to contribute to the discussion and on-going reform efforts by providing an evaluation of the role the financial system could play for enhancing growth in rural areas and the productive sector without threatening the sector’s stability. It also endeavors to update the Bank’s knowledge on the financial sector, assess its current role and recent developments, and determine possible vulnerabilities as well as core bottlenecks for the outreach to underserved segments of the population and economy.

*Overview over the evolution of the system and core financial soundness indicators*

**As in most countries worldwide, the actual level of access and use of financial services in Bolivia cannot be determined with some certainty**. A number of surveys are regularly conducted in Bolivia, but generally do not include questions on the actual access and use of financial services in the country[[3]](#footnote-3). The lack of solid demand side data makes a gap assessment difficult, and can lead to significant inefficiencies in the programming and targeting of government interventions. Supply side data however suggests that the Bolivian financial system has reached solid levels of financial depth.Compared to other countries in the region and of similar income levels, the penetration with savings is high, but a larger share of the population still uses cash as sole means of payment and the number of deposit accounts in the system indicates further room for growth. Lending volumes and number of clients are in line with countries of similar income level and structural characteristics, but the dynamic of the market has not been sufficient to keep up with GDP growth, particularly with regard to credit to the agricultural and industry sectors.

**Non-bank deposit-taking institutions play a relatively important role in the financial system, with Bolivia being known for its vibrant and mature microfinance market**. The formal microfinance sector[[4]](#footnote-4) now accounts for one-fourth of all assets, 32 percent of loans by volume and 46 percent of all borrowers. In addition to the formal financial system, Finrural[[5]](#footnote-5) and ASFI (*Autoridad de Supervisión del Sistema Financiero*) estimate that 55 IFDs (*Instituciones Financieras de Desarrollo,* which are non profit micro-finance associations) and 411 closed cooperatives (so-called *Cooperativas Societarias*) existed in October 2010, which – if actually active - in many instances cater to clients in rural and peri-urban areas. With the exception of 13 IFDs organized in FINRURAL, there is limited data available on these entities, their assets, activities as well as actual status of operation, as none of the government entity in charge of licensing these institutions has collected their financial data.

**Financial soundness indicators and competition measures do not indicate larger inefficiencies in the system.** Common measures of competition point to an open financial system, in which market forces are generally at play. With regard to financial soundness indicators, much progress was made in the last few years in reducing the share of foreign exchange denominated assets and liabilities, and in bringing the level of non-performing loans down. With solid levels of capital and profitability, and a high level of overall liquidity, the system appears at least on the short term resilient to the most common systemic shocks. However, the government needs to strike a fine balance in its policy measures to foster outreach and credit in order to not unduly lower the profitability in the financial sector, jeopardize the quality of the loan portfolio and as a result introduce vulnerability in an otherwise sound system. In particular, the strong push towards financing of the productive sector at comparatively low interest rates, can lead to over-indebtedness of the clients or a deterioration of the repayment culture, if lending institutions expanding their loan portfolios do not maintain (or introduce) prudent lending practices[[6]](#footnote-6). Both would be detrimental to achieving the declared government objective on the longer term.

*Regulatory framework*

**ASFI has started to bring the hitherto unregulated closed cooperatives and IFDs under its prudential oversight, and should be commended for this effort.** So far 14 IFDs and 63 closed cooperatives complied and initiated the transition process. Together, those 77 institutions account for an equivalent of 6 percent of assets and for 34 percent of all borrowers[[7]](#footnote-7) in the financial system, but only 4 percent in terms of deposit accounts. Given their size and importance for lending to lower income segments of the population[[8]](#footnote-8), bringing them under prudential oversight is a positive development. Experience from other countries however suggests that this process will need to be staged, will take a considerable amount of time and requires additional financial and technical support to facilitate the transition[[9]](#footnote-9). Furthermore, as the entities vary greatly in size, a differentiated regulatory approach is advisable to not unduly burden the small entities. It is for example questionable whether the smaller closed cooperatives and IFDs will be able to meet in the short to medium term the minimum capital requirements of around USD 150,000. Also, many of them do not have the size for justifying elaborate information systems, thus will find it difficult to produce the frequency and breadth of data ASFI requires. The regulatory framework also introduces hurdles for outsourcing of services, which makes reaping of economies of scale difficult.

**The government introduced a number of reforms to the regulatory framework over the last few years, which increased its compliance with Basel Core Principles (BCP) while maintaining - with a few exceptions - a regulatory level playing field between the various players.** In spite of this, some issues arise through (i) recent efforts to use the regulatory framework to direct lending away from some sectors and in favor of others and (ii) the frequency of changes, which impose substantial costs in particular on the smaller entities, as well as (iii) the comparatively high informational burden associated with the regulatory framework per se, which especially for smaller entities does not appear to be in proportion to the actual systemic risk they pose. Finally, the supervisory capacity of ASFI is stretched with the number of entities it has to supervise, the enforcement of consumer protection measures, and recent efforts to incorporate closed cooperatives and IFDs into oversight.

*Fostering outreach to rural areas*

**Over the last few years, financial entities expanded their branch network throughout the country considerably, bringing the number of branches per person to similar levels as international peers**[[10]](#footnote-10). This outreach came mostly in the form of traditional forms of branches, with modern forms of service points such as mobile branches, non-bank agents and mobile phone platforms only recently being piloted. As 90 percent of the population solely relies on cash as means of payment, there is also a comparable lack of available automated teller machines (ATM) and point of sale (POS) infrastructure in the country. The limited use of these innovative and less costly service points is in part due to the need to establish trust in the population and familiarize them with electronic payments, but is also partly the result of the complex regulatory framework which imposes significant costs for security and consumer protection measures.[[11]](#footnote-11)

**There are also a number of structural factors and gaps in the available infrastructure that make outreach to rural areas in Bolivia more costly.** Compared with other countries, Bolivia shows low levels of population density, higher poverty rates, as well as severe deficiencies in the available communication and roads infrastructure. These factors negatively impact the cost of service delivery at the rural level, and make catering to the many small locations with traditional service points unviable. Transport of cash is expensive, as one company has a *de facto* monopoly and only caters to a limited number of locations, but reforms have recently been initiated to facilitate the entry of new players. A Real-Time Gross Settlement System (RTGS) is in place and functions well, but not all financial entities are directly participating in it and the retail payment system – although dynamically developing - is fragmented.

**The analysis suggest that increasing the coverage with financial access points in more remote areas will hinge to a large extent on efforts to reduce the costs of service delivery, and on familiarizing the population with more efficient forms of financial transactions.** The population’s lack of financial education and knowledge about modern service delivery channels lowers the demand and uptake of more efficient payment services such as electronic payments, and makes a supply driven roll-out more difficult and risky. Furthermore, the regulatory burden of service delivery and gaps in communication infrastructure need to be addressed to bring costs on the supply side down, and to provide a more conducive set of incentives for covering remoter areas with financial services.

*Increasing credit to the productive sector*

**Credit to the private sector as a share of GDP decreased until recently, but a considerable shift towards smaller borrowers can be observed.** With over 350,000 mostly smaller borrowers added to the system, microcredit increased from an already high 15 percent of total credit portfolio in 2005 to now 25 percent[[12]](#footnote-12). Loans to commerce, the services sector and construction benefited the most from this evolution, and more than doubled between 2005 and December 2009. On the other hand, credit to the traditional productive sectors[[13]](#footnote-13) only increased by 23 percent over the same period of time, and now only account for 20 percent of lending (compared to 29 percent in 2005). While enterprises have in general access to working capital (partially funded by sources outside of the financial system such as remittances), they appear constrained with regard to investment financing and larger working capital loans.

**The assessment points to a number of demand and supply side bottlenecks that contributed to the more sluggish credit growth, particular in the productive sectors**:

* On the demand side, larger borrowers lowered their investments due to a decrease in international demand (i.e. in the textile sector) and uncertainties introduced through the pending translation of the new Constitution into the legal framework, which leaves room for interpretation of what constitutes priority sectors and on the actions the government will undertake with regards to them. Furthermore, grant funding is available in many sectors. Combined, these developments considerably reduce the demand for credit. Furthermore, the economic structure of the country, in particular the large share of micro and small enterprises operating in the informal and semi-formal sector, and the lack of integration into value chains impede profitability in the enterprise sector and limit growth “opportunities” for small borrowers. Particularly agricultural firms report low and volatile income, outdated small-scale production techniques and higher weather-induced risks. Thus, in the first place a larger and more coordinated effort to foster economic growth through elimination of barriers to the investment climate and vertical and horizontal integration of the micro, small and medium enterprises (MSME) sector will be required. Without these reforms, the government’s focus on credit risks leading to over-indebtedness of clients or a deterioration of the repayment culture as witnessed before, both of which would lower the availability of funding on the longer term.
* With regard to supply of credit from the financial sector, neither the available resource envelope nor the level of interest rates were determined to be significant constraints for the expansion of lending, including to the productive sector. The increase in the levels of liquidity in the formal financial system as well as moral suasion from the government created a strong competitive pressure for lending, and contributed to a reduction of lending interest rates and possibly also of lending standards. This needs to be carefully monitored, although the financial institutions appear in general to have solid credit appraisal and risk management mechanisms in place. The above mentioned demand side barriers much rather point to barriers due to the higher risks involved in lending to the productive sector (as reflected for example in consistently higher levels of non-performing loans) as well as higher costs involved in gathering information on potential clients. The fragmentation and informality of the economy and of business relations leads to broad deficiencies in available financial and economic information on enterprises, which have to be overcome through high collateral requirements for loans, the use of more expensive and labor intensive microfinance lending techniques, and lower loan amounts. This is traditionally the competency of microfinance institutions and explains their stronger growth.

**Some deficiencies were also noted in the available financial infrastructure, which increases the strong reliance on real estate as collateral.** The coverage of borrowers by the private credit bureaus – although high in an international comparison based on the Doing Business indicators – is not complete and would benefit from broader access to ASFI’s comprehensive loan database (*Central de Riesgo*). The credit bureaus also only provide information on already banked clients, thus do not facilitate the identification of potential new clients based on the latter’s electricity, water or telephone payment history. With regard to collateral, the use of movable collateral is restricted through the legal framework and the absence of a unified registry. This particularly constraints the access to loans for MSMEs, as they – like in most countries – do not have ample real estate and thus depend on being able to pledge movable collateral to receive funding[[14]](#footnote-14). The restrictions on collateral particularly impact farms and rural enterprises, as the Constitution and agrarian reform legislation subordinate properties to the obligation of owners to use the land in such a manner that it fulfills a social and economic role[[15]](#footnote-15), while small farmers cannot use their land as collateral in general. At the current stage, these restrictions on the property rights on rural land lead to a lack of collateral and hinder financial institutions from granting larger loans to farms and to rural businesses. Finally, Bolivia has one of the lowest ratings in the Doing business indicators regarding creditor rights. Enforcement is lengthy, and creditors lack priority for the collateral in bankruptcies. Ideally, reforms to the collateral regime should go hand in hand with enhancements in creditor rights.

**Constraints arising from collateral requirements can be partially solved through alternative financial products such as leasing and factoring, as well as through partial credit guarantee schemes and micro-insurance products.** The assessment shows that leasing and factoring, two loan products which may allow lending at lower cost and with no additional collateral, are not sufficiently available in the system, largely due to deficiencies in the regulatory framework but also a lack of familiarity of clients with their benefits. Products to manage the riskiness of lending or of the underlying activities, such as partial credit guarantees or crop insurance are only being developed. The careful design of such products is key, as experience in the past has shown that a flawed design can led to some distortions in the financial system (i.e. through unsustainable low prices and lax enforcement), and to a deterioration of the repayment culture of the borrowers. Furthermore, partial credit guarantees and micro-insurance can create significant recurrent contingent liabilities to the government, if not well tailored and realistically priced.

*Moving ahead*

**Over the last few years, the government actively promoted outreach of the formal financial system to underserved segments of the population and also introduced measures to foster credit growth, in particular to the productive sectors.** This included (i) the definition of norms for the consolidation of hitherto unregulated cooperatives and IFDs, (ii) the issuance of circulars and regulations to stimulate the opening of branches in rural areas, facilitate productive credit and enhance consumer protection, (iii) the provision of dedicated funding sources for productive credit through its second tier bank, and increasing focus on a potential role for its first tier public bank(s), as well as (iv) the distribution of cash transfers through financial entities. This process has been accompanied by an ongoing dialogue between the government and the different stakeholders in the area of productive credit and rural finance. The following recommendations aim to help the government fine-tune its current approach, and to highlight additional reforms needed to address core bottlenecks[[16]](#footnote-16).

*Outreach to new geographic areas and underserved segments of the population*

**To foster outreach, the above assessment suggests that the focus should be on reforms to lower the costs and risks of service delivery, and to stimulate the uptake of more efficient payment options by the population.** The government could carry out a number of reforms to complement and refocus the abovementioned ongoing efforts. In particular, it should consider shifting its focus away from introducing regulatory measures that provide mixed incentives, and instead emphasize on its role as enabler and facilitator and use its market presence as the largest user of financial services to set positive incentives. Specifically, the government can do the following:

* Planned survey work needs to be carried out to (i) bridge the knowledge gap on the population’s actual access and use of financial services, (ii) determine *de facto* coverage gaps, and (iii) assess potential cultural factors and knowledge gaps that impede uptake.
* The regulatory framework should be revised to reduce the costs for security, oversight and administrative burden for mobile branches, mobile banking technology and non-bank agent models. These alternative channels will likely play an important role for delivering financial services to less densely populated areas in the future. Furthermore, a careful assessment of the legal and regulatory framework should be undertaken to assess gaps and needed revisions of laws and regulations pertaining to e-commerce, e-money and the role of mobile network operators / non-bank agents[[17]](#footnote-17). The needed changes should then be put in place as soon as possible to provide clarity and security to those solutions.
* The communication and available ATM / POS infrastructure should be enhanced to facilitate the use of modern financial access points in more remote areas, and to reduce costs and risks of transactions. This could be done through providing positive incentives such as making communication infrastructure available in targeted locations, providing tax incentives or subsidies for investments or costs incurred, or linking government cash transfers (see next point).
* The way the vast number of government payments to individuals and businesses are delivered can play an important role for the development of alternative payment channels. The government could explore options of using its market presence to foster the supply and uptake of financial access points, and also to familiarize the population with electronic payment options such as debit cards and mobile phone platforms. It would be beneficial for the development of the system to involve the private financial system were possible, in order to provide positive incentives and lower initial start-up costs involved with covering hitherto underserved geographic areas.
* Financial education programs would be needed to familiarize the population, in particular in rural areas and where necessary in local languages, with the benefits and risks of using modern forms of payments for their transactions.

*Fostering credit to MSMEs, in particular in the productive sector*

**The growth of loan portfolios to MSMEs, in particular in the productive sector, requires measures to strengthen both demand and supply of these services.** Aside from specific actions to enhance the environment for the supply of financial products, it is highly recommended to take additional measures to strengthen the businesses environment and develop value chains. Pushing credit without at least simultaneously addressing constraints in the latter two will not be effective and can even be counterproductive, if loans are granted to grow MSMEs which are not well equipped to put the credit into productive use. In addition, it is advisable to implement measures that reduce existing uncertainties in the market, by providing a clear definition of the specific role and foreseen actions of the state in each of the sectors of the economy.

**With regard to reforms to foster the supply of credit by the financial sector, a number of efforts could be considered that would allow taking advantage of the already well-developed institutional landscape serving to MSMEs in Bolivia:**

* **Survey work planned by the government should incorporate a dedicated module that looks at the actual access and use of financial services by MSMEs.** This would facilitate an understanding of actual sources of funding and *de facto* constraints, and provide needed information to tailor and design policy interventions and monitor their effectiveness. In order to increase the usefulness of the information gathered for different public and private stakeholders, it would be advisable to unify the definition of the different types of enterprises by size[[18]](#footnote-18) among all public and major private institutions.

* **A second important area of work relates to alleviating the difficulties faced by MSMEs to provide collateral for loans.** In the case of rural land that is subject to specific restrictions of the property rights, it is recommended to explore options to facilitate its use (or the use of its usufruct) as collateral. A very precise definition of the economic and social objectives that land has to fulfill might additionally contribute to reduce uncertainty and facilitate lending in rural areas. In addition, the legal and regulatory framework for movable collateral needs to be enhanced to foster the use of alternative forms of collateral, and a unified registry developed. Finally, creditor rights need to be strengthened, in particular out-of court enforcements of contracts and collateral.
* **To reduce existing information asymmetries, efforts to enhance business links and increase the available information on enterprises need to be made.** Increasing formality in doing business requires support for linking enterprises vertically and horizontally, in particular through value chains. Efforts to this regard are already underway by various government agencies and private sector stakeholders, but need to be better coordinated and focused. The government should also promote the inclusion of positive information from utilities, telephone companies and other services into the credit bureau infrastructure, as well as providing the private credit bureaus access to information on all type of loans to facilitate credit appraisal. In addition, auditing and accounting in the country should be strengthened and focus on the needed auditing and accounting framework for small and medium sized enterprises[[19]](#footnote-19).
* **The development and roll-out of innovative credit products could be promoted through reforms of the legal and regulatory framework for leasing, factoring, and risk capital, as well as the provision of partial credit guarantees and micro-insurance products.** In the area of leasing, ASFI could consider allowing leasing operations to be conducted by a dedicated unit within existing financial entity instead of mandating the creation of a separate financial entity. Similar regulations have rendered positive results in other countries, in which measures were undertaken to maintain an adequate separation and control of the leasing departments to avoid misuse. Factoring and partial credit guarantees could also be promoted, especially as part of the actions to strengthen value chains, while information campaigns could be helpful to familiarize the population with the requirements and benefits of these innovative products.

**While public banks can play a role in addressing bottlenecks and market failures, lessons learned from other countries suggest that their mandate needs to be defined more precisely and with a clear and limited scope, and that transparent governance structures and enforceable budgetary limits should be established to foster long-term institutional viability.** Establishing these preconditions should help maintain a healthy public banking system that does not rely on contingent public resources while simultaneously being able to achieve progress towards social and economic goals.

* In the case of the *Banco de Desarrollo Productivo* (BDP), it is recommended to redefine and reorient its role, moving it fully away from first tier lending at subsidized rates and refocusing it on facilitating the introduction of innovative products. As done by some public banks in other countries (i.e. Mexico and recently in Paraguay), the BDP could for example foster the development of targeted products to individual sectors with the aim to familiarize the financial entities with the characteristics of the respective sector, needed credit conditionalities and repayment cycles, and available guarantees.
* The government should also define more precisely the role that *Banco Union* will play for the development of the financial system. As recent reform measures indicate, there is the risk that *Banco Union* will be burdened with too many roles, and lose traction and focus. Reducing the scope of *Banco Union*’s intervention (e.g. in paying salaries to public employees) could free the bank to focus on taking concrete actions to expand the frontier of finance in more remote areas that are not yet covered by a financial institution, and to address specific market failures affecting underserved priority sectors (e.g. the lack of longer-term investment loans for rural enterprises).
* For both banks (or any future public bank), the programs need to be developed based on a prior demand side survey, and include a monitoring and evaluation framework to track their effectiveness, the uptake of those products in the private sector on their own balance sheet, and actual achievements in the real sector. A sunset clause for individual product lines that only address temporary market failure would be helpful to maintain the innovative capacity of the institutions and limiting budgetary exposure.

With regard to the sequencing of reforms, the recommended assessments of the regulatory framework for innovative financial service points and consumer protection should be carried out as soon as possible to provide the needed input into the new financial system law. Ideally, the new legal framework should also incorporate the suggested reforms in the area of leasing, factoring and movable collateral / creditor rights, but as these have proven to be more difficult in the past and will require broad stakeholder participation, they will likely have to be addressed in the short to medium term through separate framework laws. For the efficient and well targeted roll-out of the other suggested reforms, the survey on the actual use and demand for financial services should be conducted first, and the individual reforms based on its results. Furthermore, considerations should be given within the next 6 month to pilot a number of alternative payment delivery mechanisms for government transfers, such as via prepaid cards or into accounts, which could then in the medium term be rolled out.

# Introduction

1. **Bolivia benefited from an overall favorable economic evolution in the last few years.** The economy grew in real terms on average by 5.2 percent during 2006 and 2008 due to positive external conditions, in particular higher commodity prices coupled with strong external demand for Bolivia’s minerals, gas and other natural resources, as well as strong domestic demand supported by government investments and redistribution programs. After temporarily slowing to 3.4 percent in 2009 as a result of reduced gas demand from Brazil in the context of the world wide economic and financial crisis, as well as weather induced shortfalls in agricultural output, growth picked up to 4.1 percent in 2010 and is expected to stay in that range in the next year.
2. **Sound macro-economic indicators supported this solid economic growth.** The overall fiscal balance remained positive between 2005 and 2009, leading to a reduction of government bonds available on the domestic market and facilitating a sharp reduction of their interest rates. Inflation temporarily increased to over 11 percent in 2007 and 2008 due to spikes in food and commodity prices worldwide, then come down again to around zero percent, but recently increased again due to higher food and oil prices. The country generated external surpluses in the current account in the range of 12 percent of GDP[[20]](#footnote-20), which led to a strong growth in the net international reserve position of the Central Bank (CB). Combined, these indicators contributed to an appreciation of the currency from over 8 Bs. per USD in 2005 to now below 7 Bs.
3. **However, economic growth was unevenly distributed between the sectors.** Extractive industries reported the largest growth in the last few years, growing in real terms byclose to 13 percent per year between 2006 and 2008. In combination with favorable price developments, the sector now accounts for 16 percent of nominal GDP[[21]](#footnote-21) compared to 12 percent in 2005. Construction and financial services also reported above average growth rates of around 12 percent in real terms, and now account for 3.1 and 4.5 percent of nominal GDP compared to 2.7 and 4.0 in 2005. On the other hand, agriculture, which according to INE (*Instituto Nacional de Estadística de Bolivia*)employs around 40 percent of the population and on which 77 percent of the rural population depends upon as main source of income, only grew by 2.5 percent in real terms. Despite favorable developments for some prices on the world market, it now only contributes 13.8 percent to GDP compared to 14.4 percent in 2005. In the manufacturing sector, growth was mostly held up by oil refinery, non-metallic minerals, tobacco and drink production, while textiles, wood and other industries showed below average growth. Finally, communication and tourism reported low growth rates.
4. **In order to foster a more balanced and equitable growth, the reform program of the Government of the Plurinational State of Bolivia has a strong focus on fostering the productive sector and increasing employment.** Reform measures were already included in the National Development Plan of 2007 (*Plan Nacional de Desarrollo* - PND), in which measures to enhance the productivity and integration of the productive sectors feature prominently.[[22]](#footnote-22) Most of these measures aim at helping integrate the productive sector horizontally and vertically into the economy - one of the core bottlenecks confirmed also in this report.
5. **Following the mandates of the new Constitution, the government’s efforts in the financial sector focus on direct and indirect measures to increase the provision of credit for productive purposes and to enhance access to financial services for all.** The new Constitution dedicates a chapter to the role of the financial sector, introducing solidarity and equality as guiding principles. This builds on and furthers reform measures already spelled out in the National Development Plan, which aimed to (i) set up a second tier development bank to foster the productive sector and micro, small and medium sized enterprises, and (ii) introduce legal, regulatory and institutional reforms to increase the provision of financial services in rural areas and to productive sectors. To implement the constitutional mandate, the three core government agencies for the financial sector - the Ministry of Economy, the Central Bank and ASFI – initiated a roundtable (the so called “*mesa tripartita”*) to discuss and coordinate efforts. They already issued a number of regulations and reforms to increase the number of financial service points in rural areas and facilitate access to credit to the productive sectors. The government also organized a series of workshops and seminar with the stakeholders to discuss possible reform measures[[23]](#footnote-23). In the context of the new Constitution, a series of new laws are being revised, amongst them a new financial system law.
6. **This paper aims to contribute to the discussion and on-going reform efforts by providing an evaluation of the role the financial system could play for enhancing growth without threatening its stability** It also endeavors to update the Bank’s knowledge on the sector, assess the sector’s current role and recent developments, and determine possible vulnerabilities as well as core bottlenecks for the outreach to underserved segments of the population and economy. With view to the recent Financial Sector Assessment Program (FSAP) mission, a stronger focus was placed on access to financial services, and within these, following a request of the government[[24]](#footnote-24), on outreach to rural areas and enhancing the supply of credit to the productive sectors. The report is structured as follows. Chapter 2 provides a general overview over the composition of the financial system, and where the country stands with regard to the depth of the financial system in comparison with other countries in the same income bracket, region or that have similar characteristics. Market segmentation and competition, as well as a general assessment of the efficiency and potential vulnerability of the financial sector will be discussed in Chapter 3, with the aim to determine bottlenecks that might arise of the structural composition and efficiency of the sector. Chapter 4 evaluates the conduciveness of the regulatory framework for fostering outreach. Finally, Chapter 5 and 6 take an in-depth look into the two core topics, with Chapter 5 assessing the current situation and core bottlenecks for provision of financial services in rural areas, and Chapter 6 focusing on credit to MSMEs, in particular from the productive sector, and what could be done to improve their use and access of credit through the formal financial system.

# Composition and depth of the financial system

*With its large and mature micro-finance sector, the Bolivian financial system reports a solid level of financial depth. Compared to other countries in the region and of similar income levels, the penetration with savings services appears comparatively good, but a larger share of the population is still using cash as sole means of payment. Lending volumes and number of clients are in line with countries of similar income level and structural characteristics, but the dynamic of the market has not been sufficient to keep up with GDP growth, particularly with regard to credit to the agricultural and industry sectors. The reach of the formal financial system will be significantly expanded through the ongoing incorporation of the hitherto unregulated financial institutions under the purview of ASFI.*

## A brief overview over the core players

1. **The formal financial system in Bolivia is composed of a diverse set of financial institutions, with supervised deposit taking financial institutions accounting for 94 percent of assets of financial intermediaries.** The formal financial sector includes 12 banks, 5 finance companies, 8 savings and loan associations (SLAs, so-called *Mutuales*) and 25 open Cooperatives[[25]](#footnote-25) (CAC, so-called *Cooperativas Abiertas*), all of which are supervised by ASFI. The composition of the system changed since 2004, when *Banco Mercantil* and *Banco Santa Cruz* merged to the largest bank in the system, and *Citibank* closed its Bolivian branch. Two finance companies (*Los Andes* and recently *FIE*) transformed into microfinance banks, one of the open cooperative was intervened and liquidated[[26]](#footnote-26) and some of the so far unregulated closed cooperatives have initiated the process of converting into open cooperatives. Finally, the assets of *Mutual Guapay* were liquidated and its assets sold to *Banco Bisa*. There are two public banks, the first-tier bank *Banco Unión* accounting for 6 percent of assets*,* and a small second-tier bank*, Banco de Desarrollo Productivo* (BDP).
2. **While banks dominate the formal financial system, other deposit-taking institutions play a relatively important role, contributing to a vibrant microfinance market in the country**. As can be seen in Table 1, the savings and loan associations account for a large asset base, but due to their strong focus on larger housing loans account for only 1 percent of loans by number. On the other hand, the finance companies and open cooperatives account for a combined 10 percent of all assets, but together represent around 32 percent of all deposit accounts and 22 percent of borrowers. Particularly the formal cooperative sector is large in regional comparison, with only Paraguay and Ecuador reporting a higher share of assets for their cooperative sector. Together with the three microfinance banks[[27]](#footnote-27), the formal microfinance sector accounts for one-fourth of all assets, 32 percent of loans by volume and 46 percent of all borrowers.

Table 1: Composition of Bolivia's financial system (November 2010, excluding insurance, pensions capital market and the second tier public bank)

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Number of entities** | | **Assets** | | **Deposits** | | **Loans** | | **Deposit Accounts** | | **Borrowers** | |
| **in mio USD** | **%** | **in mio USD** | **%** | **in mio USD** | **%** | **number** | **%** | **number** | **%** |
| ***Formal financial system*** | | | | | | | | | | | |
| **Banks** | 12 | 9,263 | *77* | 7,540 | *79* | 5,209 | *73* | 2,877,166 | *55* | 544,457 | *42* |
| ***foreign subsidiaries*** | *2* | *47* | *0* | *14* | *0* | *16* | *0* | 2,025 | *0* | *184,827* | *14* |
| ***commercial banks*** | *6* | *6,853* | *57* | *5,790* | *61* | *3,569* | *50* | 1,388,180 | *26* |
| ***public bank*** | *1* | *698* | *6* | *566* | *6* | *394* | *6* | 250,392 | *5* |
| ***MFI banks*** | *3* | *1,665* | *14* | *1,170* | *12* | *1,230* | *17* | 1,236,569 | *24* | *359,630* | *24* |
| **SLAs** | 8 | 912 | *8* | 693 | *7* | 310 | *4* | 388,938 | *7* | 19,251 | *1* |
| **Finance Companies** | 5 | 581 | *5* | 445 | *5* | 660 | *9* | 886,341 | *17* | 189,091 | *15* |
| **Open Cooperatives** | 24 | 571 | *5* | 455 | *5* | 407 | *6* | 779,316 | *15* | 94,760 | *7* |
| **Total formal system** | **62** | **11,327** | ***94*** | **9,133** | ***96*** | **6,586** | *93* | **4,931,761** | *94* | **847,559** | *66* |
| ***Hitherto unregulated financial entities*** | | | | | | | | | | | |
| **Closed Cooperatives** | 63 | 392 | *3* | 353 | *4* | 272 | *4* | 339,576 | *4* | 72,621 | *6* |
| **IFDs** | 13 | 273 | *2* | - | *0* | 235 | *3* | - | *0* | 369,040 | *29* |
| **Total unregulated** | **76** | **665** | ***6*** | **353** | ***4*** | **506** | ***7*** | **339,576** | ***4*** | **441,661** | ***34*** |
| ***TOTAL*** | ***138*** | ***11,992*** | ***100*** | ***9,486*** | ***100*** | ***7,093*** | ***100*** | ***5,281,337*** | ***100*** | ***1,289,220*** | ***100*** |
| *Source: ASFI (data for November 2010), ASOFIN (for number of MFI bank borrowers, data for December 2010).* | | | | | | | | | | | |

1. **In addition to the formal financial system, there are a significant number of hitherto unregulated financial institutions, which also cater to otherwise under-banked segments of the population.** According to Finrural and ASFI, there were an estimated 55 IFDs (*microfinance NGOs* called *Instituciones Financieras de Desarrollo*) and 411 closed cooperatives (so-called *Cooperativas Societarias*) as of October 2010, which in many instances cater to clients in rural and peri-urban areas. With the exception of 13 IFDs organized in FINRURAL[[28]](#footnote-28), there is limited data available on these entities, their assets, activities as well as actual status of operation, as none of the government entities in charge of licensing these institutions has collected their financial data[[29]](#footnote-29).
2. **Given their outreach and the fact that closed cooperatives take deposits, ASFI issued in 2008 a new law to bring closed cooperatives and IFDs under their prudential oversight.** So far 14 IFDs and 63 closed cooperatives complied and initiated the transition process. Based on available data from ASFI, the 63 closed cooperatives report assets of close to USD 400 million, and provide deposit, payment and loan services to roughly 600,000 members. The IFDs do not take deposits, and so far rely on donors and other external sources for funding. The 13 IFDs reporting to FINRURAL reached a loan portfolio of USD 270 million at the end of 2010, and cater to 370,000 borrowers, mostly low income women. Together, those 77 institutions account for an equivalent of 6 percent of assets in the financial system and for an estimated 34 percent of all borrowers[[30]](#footnote-30). Given their size and importance for lending to lower income segments of the population[[31]](#footnote-31), bringing them under prudential oversight is a positive development, but will likely need time and additional support to facilitate the transition[[32]](#footnote-32) and must consider the cost-benefit balance for these entities.

## Financial depth and level of financial inclusion – an international comparison

1. **With a deposit to GDP ratio of 48 percent, Bolivia surpasses many of its peers in the region and income level with regard to financial depth.** According to calculations of the World Bank, a country with similar structural factors is expected to have a median deposit and credit to GDP ratio of around 22 percent (for both)[[33]](#footnote-33) – a value that Bolivia with its vibrant microfinance sector easily achieves (see Chart 1). Bolivia’s private sector credit and deposit to GDP ratios are ahead of other countries in the region such as Paraguay, Peru, the Dominican Republic and Guatemala, and also compare favorably to selected countries in Africa, which have recently made headways in spearheading modern technologies for access to finance by low-income populations. Yet, there is untapped potential for additional depth in those ratios as some countries in Eastern Europe, the Middle Eastern Region and in the Latin America and Caribbean (LAC) region show.
2. **Like in most countries, the actual level of access and use of financial services in Bolivia cannot be determined with some certainty**. A number of surveys are regularly conducted in Bolivia, but generally do not include questions on the actual access and use of financial services in the country[[34]](#footnote-34). Neither are private sector estimates or assessments of the actual level of access available. The World Bank (2007) estimated that in mid 2000 around 30 percent of the population had access to formal financial services, but findings from the missions suggest that currently a much larger share of the population has access and uses the financial system at least for cash-based transactional purposes. The lack of solid data is not unusual, as most countries in the region and also worldwide are only starting to include questions on the use of financial services and level of financial education in their household surveys. However, the absence of demand side data makes a gap assessment difficult, and can lead to significant inefficiencies in the programming and targeting of government interventions. To tackle this issue, the authorities are considering options to incorporate demand side questions on the use of financial services in their household surveys, and also to occasionally conduct stand-alone in-depth surveys on financial literacy.

|  |  |
| --- | --- |
| Chart 1: Deposits and credit to the private sector (as % of GDP) – an international comparison | |
|  |  |
| *Source: IMF IFS data and World Bank’s FinStat database, which include entire formal systems.* | |

*Deposits*

1. **Deposits in the formal financial system saw unprecedented growth rates in the last few years.** Deposits account for around 90 percent of liabilities and – as in most countries - are the core funding sources for financial entities. The value of deposits in the deposit taking institutions more than doubled in nominal terms during the last 5 years, reaching the equivalent of USD 9 billion. These growth rates were high in international comparison (see Chart 2) and outpaced GDP growth, leading to an increase in deposits as percent of GDP from 36 percent of GDP in 2006 to 48 percent in 2010[[35]](#footnote-35). The increase in deposits was particularly pronounced in sight deposits[[36]](#footnote-36), which now account for two-third of all deposits in commercial banks, the public bank and SLAs.
2. **The number of deposit accounts in the formal financial system also more than doubled between 2006 and November 2010, reaching close to 5 million accounts in December 2010[[37]](#footnote-37).** The growth in deposit volume and number of accounts was mostly due the opening of savings accounts with an account balance of less than USD 500, indicating that new clients with lower income levels are increasingly being banked. In the absence of demand side information, it is not clear what triggered this strong growth, but interviews and transaction volumes indicate that most of the accounts are used for savings purposes only. There are now on average 7 accounts for 10 adults in Bolivia - a comparatively good result for a country of Bolivia’s income level. Pakistan, Paraguay and Nicaragua show for example ratios of 2 to 5 accounts per 10 adults. Yet, richer regional peers report more than 1 deposit or checking account per adult, indicating the population’s use of various accounts for transactional and savings purposes. This is an area in which Bolivia still has further room for growth[[38]](#footnote-38) as will be discussed below. The stronger inclusion of clients with lower income levels led to a drop in average deposit values to 239 percent of income per capita.[[39]](#footnote-39) Bolivia is now ahead of other countries in the region such as Panama, Paraguay and Nicaragua who report average deposit values of between 330-800 percent of per capita income.

|  |  |
| --- | --- |
| Chart 2: Deposits – international comparison of growth rates and number of accounts | |
|  |  |
| *Source: CGAP Financial Access database (2009), IMF IFS data, ASFI and World Bank’s own calculations ( entire formal system).* | |

*Credit*

|  |
| --- |
| **Chart 3: Credit, deposits and GDP (in billion Bs.)** |
|  |
| *Source: IMF IFS data and World Bank’s own calculations.* |

1. **Credit to the private sector also increased in the last 5 years, but the growth was not sufficient to keep up with deposit and GDP growth rates.** Based on IMF data, credit to the private sector increased in nominal terms on average by 6.5 percent annually between 2005 and 2008, which was below the growth rates achieved in other countries in the region and income bracket (see Chart 4), and well below deposit and GDP growth. As a result, credit to the private sector in percent of GDP decreased from around 40 percent in 2005 to 34 percent in 2009. The different growth dynamic to deposits led to a widening of the intermediation gap, with now only two thirds of the deposits being intermediated into loans compared to 91 percent in 2005. However, it should be noted that this trend reversed in 2010, as credit growth accelerated to 20 percent – now one of the highest in the region - and deposit growth slowed down (see Chart 3 and 4).Both supply and demand side factors contributed to the comparatively weak growth of credit volume, as will be discussed in more depth in Chapter 6.

|  |  |
| --- | --- |
| Chart 4: Credit – international comparison of growth rates and number of loans | |
|  |  |
| *Source: CGAP Financial Access database (2009), IMF IFS data, ASFI and World Bank’s own calculations (entire formal system).* | |

1. **Since 2006, the number of borrowers in the formal financial system increased by 50 percent, leading to a larger share of borrowers with small to medium sized credits**. There are currently over 850,000 borrowers in the formal financial system, which represent around 15 percent of the adult population or in terms of number of loans equals 0.6 loans per adult. The latter is above international peers and regional averages (see Chart 4), reflecting the strong microfinance system in the country. The data for the formal financial system reveal a significant shift in the composition to micro- and small clients with a loan portfolio of between USD 1,000 to 30,000. Yet, less than 1 percent of the borrowers still account for over 40 percent of the loan portfolio by volume, leading to a high average lending value of over 500 percent of GDP per capita. This is comparatively high for the region, and also for other countries in the same income category, but masks the fact that the system does cater to a substantial part to micro- and small enterprises[[40]](#footnote-40). In addition to the formal financial sector, it is estimated that the IFDs and closed cooperatives are serving around 440,000 borrowers.
2. **Demand side data confirm that formal enterprises have access to funding from the formal financial sector, but mostly in the form of working capital and with high collateral requirements**. As can be seen in Table 2, 50 percent of the 651 firms interviewed for the World Bank’s Enterprise Survey in 2006 had access to short-term funding in the form of lines of credit and a large share reported being able to obtain working capital from banks. Thus, only 20 percent of the surveyed formal companies’ perceived access to finance as a bottleneck for their business compared to 28 percent for the Latin American region, and 31 for all sample countries worldwide. Smaller companies reported a slightly lower level of access to financing (40 percent), which however is still comparatively good. Investment financing is only used by 22 percent of the companies, and collateral requirements are in general high. Thus, while working capital financing appears to be sufficiently available overall, funding for investment capital appears constrained and limited by the requirements for collateral[[41]](#footnote-41). The findings from the enterprise survey were confirmed by interviews in the field for both formal and informal enterprises.

Table 2: Survey results for formal enterprise’s access to credit from formal financial institutions

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Bolivia** | **Region** | **All countries** |
| % of Firms with Line of Credit or Loans from Financial Institutions | 50 | 47 | 34 |
| % of Firms Using Banks to Finance Investments | 22 | 21 | 24 |
| % of Firms Using Banks to Finance Working Capital | 39 | 36 | 28 |
| Value of Collateral Needed for a Loan (% of the Loan Amount) | 188 | 134 | 144 |
| % of Firms Identifying Access to Finance as a Major Constraint | 20 | 28 | 31 |

*Source: World Bank, Enterprise Survey (2006).*

*Geographic outreach*

1. **Supported by government reform measures, Bolivia’s core indicators of financial access showed a significant improvement over the last 3 years**. The number of branches[[42]](#footnote-42) of formal financial institutions increased by 66 percent since 2007 (equivalent to 484 new branches, see Table 3), reaching nowadays 1,218 branches. This growth was in particular fueled by a rapid expansion of branches of microfinance banks and finance companies (+85 percent), which by April 2010 accounted for 55 percent of all branches in the formal financial system (up from 45 percent in 2007). In addition to branches from the formal sector, IFDs reporting to FINRURAL currently operate a total of 330 branches and the closed cooperatives which have initiated the transition into being regulated another 128.

Table 3: Evolution of branches in the formal financial system by department

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Dec-07** | **Jan-11** | **Growth (Dec 07-Jan 11)** | **Points per**  **10,000 adults** | | **Share of total** |
| **Dec-07** | **Jan-11** |
| La Paz | 210 | 362 | 72% | 1.3 | 2.1 | 30% |
| Santa Cruz | 206 | 341 | 66% | 1.5 | 2.2 | 28% |
| Cochabamba | 114 | 193 | 69% | 1.1 | 1.8 | 16% |
| Oruro | 17 | 37 | 118% | 0.7 | 1.4 | 3% |
| Pando | 9 | 13 | 44% | 2.4 | 3.0 | 1% |
| Potosí | 49 | 67 | 37% | 1.2 | 1.6 | 6% |
| Tarija | 48 | 88 | 83% | 1.7 | 2.8 | 7% |
| Beni | 43 | 57 | 33% | 2.0 | 2.4 | 5% |
| Chuquisaca | 38 | 60 | 58% | 1.2 | 1.7 | 5% |
| TOTAL | 734 | 1,218 | 66% | 1.3 | 2.03 | 100% |

*Source: ASFI.*

1. **While the brunt of the service points continue to be located in urban areas, Bolivia has now bridged part of the distance to its regional peers with regard to geographic penetration rates of the formal system**. There are on average 2 branches per 10,000 adults (compared to 1.3 in December 2007), with penetration rates for the individual departments now ranging from 1.4 to 3 branches per 10,000 adults (compared to between 0.7 and 2.4 in 2007). This overall level of penetration is getting closer to the regional average of 2.5 branches per 10,000 adults in Latin America, 2.1 for East Asia & Pacific, 2.3 for the Middle East and North Africa, and is well above the 1.1 and 1.2 branches reported for South Asia and Sub-Saharan Africa (see Chart 5).

|  |  |
| --- | --- |
| Chart 5: Branch penetration rates – an international comparison | |
|  |  |
| *Source: CGAP Financial Access database (2009) and World Bank’s own calculations.* | |

*Payment system infrastructure*

1. **The population does not make much use of the available electronic payment mechanisms in the market**. Surveys from the Bolivia’s Central Bank in 2009[[43]](#footnote-43) indicate that only 10 percent of the population in the four largest cities used some form of electronic means of payment, while the rest uses predominantly cash for their payments, even when involving financial institutions for utility payments. Between 60-80 percent of the interviewed population had some knowledge about checks, credit and to some extent also debit cards, but only 10-20 percent knew of electronic transfers and direct debits. The survey also indicates that the population associates higher risks with electronic payments. These findings were confirmed in conversations with some financial entities and a utility company, which reported for example of the difficulty of motivating clients to pay bills electronically via automatic debit programs or through internet banking, and of the preference of employees to receive their salaries in cash instead of a deposit into their savings or checking accounts. These findings reveal significant cultural factors that impede the use of modern forms of payments, and suggest the need for both government and private-led initiatives to foster financial education.

Table 4: Evolution of payment system infrastructure in Bolivia (2004-2009)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **2004** | **2005** | **2006** | **2007** | **2008** | **2009** |
| Number of ATMs | 416 | 490 | 517 | 566 | 738 | 859 |
| Number of POS | 1,570 | 1,837 | 1,735 | 1,827 | 2,481 | 3,389 |
| Number of Debit Cards | 376,478 | 406,291 | 526,000 | 616,000 | 927,900 | 1,169,653 |
| Number of Credit Cards | 57,486 | 56,040 | 51,557 | 53,410 | 66,709 | 70,734 |

*Source: Central Bank of Bolivia.*

1. **In the absence of demand for more modern means of payment, the available financial payment infrastructure is mostly used for interbank clearance and transfers.** The number of automated teller machines (ATMs) and point of sales (POS) in the system increased significantly since 2007 (+42 percent, see Table 4), but this increase was not sufficient to catch up with coverage ratios reached by neighboring and peer countries (see Chart 6).

|  |  |
| --- | --- |
| Chart 6: ATM and POS – an international comparison | |
|  |  |
| *Source: CGAP Financial Access database (2009) and World Bank’s own calculations.* | |

In many instances the available payment system infrastructure is not well connected, and clients are encouraged to use it only for transactions within the same financial institution. Many of the financial institutions still only offer bill payments in cash to the population and only to a limited extent electronic transfers to third parties as a service[[44]](#footnote-44).

# Competition and financial soundness of the financial system

*The overall levels of competition as well as profitability play an important role for the development and deepening of the market. The analysis of the core competition and financial soundness indicators suggests that the financial system is open for new entrants, shows sufficient levels of competition and efficiency, and has adequate levels of capital to weather the most common shocks. Much progress was made in reducing the share of foreign exchange denominated assets and liabilities, and in bringing the level of non-performing loans down. There is no indication that barriers to market development exist from this side.*

## Concentration and competition

|  |
| --- |
| **Chart 7: 3 largest banks’ assets to total assets of formal system** |
|  |
| *Source: World Bank’s FinStat database 2009 (Bankscope).* |

1. **The composition of the system as well as common measures of competition point to an open financial system, in which market forces are generally at play**.Several measures of concentration point to a moderately competitive banking system, with market pressures on the rise due to the strong growth of microfinance institutions. The Herfindahl index, which is commonly used to measure the level of competition between banks, recently improved from close to 1,500 in 2008 to 1,250 in 2010[[45]](#footnote-45).The market shares of the largest 3 and 5 banks also tended downwards over the last few years, and appear with currently 50[[46]](#footnote-46) and 72 percent to be in the normal range for a country of this income level and size (see Chart 7)[[47]](#footnote-47). This increase in competition is mostly due to the strong push from microfinance institutions into becoming banks, and their rapid expansion over the last years.
2. **There do not appear to be any market entry hurdles in place.** Banks are required to have a minimum capital of DEG 5.5 million (equivalent to USD 8.7 million), which is for example below the around USD 10 million required in most of the Central American countries. Furthermore, financial entities can initially operate as finance company, which allows them to offer a significant range of products while only requiring a minimal capital of around USD 1 million. The latter seems to have been the most common approach in the last few years[[48]](#footnote-48)**.**
3. **Market concentration rates for banks are higher in some of the smaller departments, but this is mitigated by the presence of non-bank financial institutions.** Some of the departments show a market share of the largest 3 banks of well above 70 percent for banking deposits, albeit with a downward trend over the last few years due to the emergence of microfinance banks and increases in the overall bank branch networks. Banks also compete with both formal and informal deposit taking financial institutions, as can for example be seen by the significant market share for credit of cooperatives and finance companies in *Potosi* and *Tarija* (see Table 5). The competition between banks and more microfinance oriented financial entities is mostly for small and medium sized enterprises and formal employees, and in some sectors (i.e. forestry, construction, and commerce).

Table 5: Market shares (for credit) of financial entities by department

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **%** | **Banks** | **Open Cooperatives** | **Finance Companies** | **SLAs** | **IFDs** | **Total** |
| La Paz | 77 | 0 | 8 | 11 | 4 | 100 |
| Santa Cruz | 84 | 7 | 7 | 0 | 2 | 100 |
| Cochabamba | 71 | 8 | 14 | 4 | 3 | 100 |
| Oruro | 66 | 1 | 13 | 10 | 10 | 100 |
| Potosi | 50 | 26 | 15 | 4 | 5 | 100 |
| Tarija | 65 | 17 | 12 | 0 | 6 | 100 |
| Chuquisaca | 72 | 4 | 11 | 8 | 5 | 100 |
| Beni | 57 | 9 | 22 | 4 | 9 | 100 |
| Pando | 49 | 12 | 16 | 13 | 10 | 100 |
| *Source: ASFI and FINRURAL.* | | | | | | |
|  | | | | | | |

1. **While the various types of financial institutions continue to focus on different client segments, the lines are becoming more blurred in the last years.** As can be seen in Table 6, the foreign subsidiaries and commercial banks – here understood as private commercial banks that do not have a micro-finance focus – tend to generally attract richer clients and larger enterprises, while the microfinance banks, finance companies and cooperatives focus on clients with lower income levels and thus show smaller average deposit and credit sizes. However, the

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Table 6: Market segmentation | | | | |
| In USD | **Average loan size per borrower** | | **Average deposit size** | |
|  | **2008** | **2010** | **2008** | **2010** |
| Banks | 9,411 | 11,346 | 3,958 | 2,794 |
| Foreign subsidiaries | 227,850 | 161,044 | 7,999 | 13,614 |
| Commercial banks | 21,480 | 24,293 | 6,753 | 4,016 |
| MFI banks | 2,624 | 3,447 | 956 | 931 |
| Public bank | 43,911 | 50,767 | 2,768 | 2,533 |
| SLAs | 14,565 | 17,340 | 1,220 | 1,182 |
| Finance Companies | 2,616 | 4,024 | 671 | 805 |
| Open Cooperatives | 3,882 | 4,962 | 483 | 579 |
|  |  |  |  |  |
| Closed Cooperatives | n.a. | 3,745 | n.a. | 1,040 |
| IFDs | 500 | 636 | n.a. | n.a. |
| *Source: ASFI, ASOFIN, FINRURAL and World Bank’s calculations.* | | | | |

existing market segmentation is starting to blur, as commercial banks increasingly also reach out to clients with deposits of less than USD 500 in order to diversify their funding sources, while microfinance institutions have attract larger depositors with their slightly higher interest rates. This is reflected in the evolution of the average deposit sizes, which for commercial banks came down, but increased for micro-finance institutions. As will be discussed later, this stronger competition contributed to a decline in lending rates for all types of borrowers, and a narrowing of the spreads between lending and deposit rates for individual types of loans.

## Selected financial soundness indicators and potential vulnerabilities

1. The assessment of financial soundness indicators does not point to imminent vulnerabilities in the financial system. Over the last years much progress was made in reducing the share of foreign exchange denominated assets and liabilities, and in bringing the level of non-performing loans down. With solid levels of capital and profitability, and a high level of overall liquidity, stress tests recently carried out confirm that the system appears in general resilient to the most common systemic shocks. However, the government needs to strike a fine balance in its policy measures to foster outreach and credit to not unduly lower the profitability in the financial sector and jeopardize the quality of the loan portfolio on the medium term, and as a result introduce vulnerability in an otherwise sound system. In particular, the strong push towards financing of the productive sector at comparatively low interest rates can lead to over-indebtedness of the clients or a deterioration of the repayment culture, if lending institutions cannot expand their loan portfolios by maintaining (or introduce) prudent lending practices and the push towards lending is not accompanied with reforms to address bottlenecks in the business environment. Both over-indebtedness and lower repayment culture would be detrimental to achieving the declared government objective of fostering access to funding on the longer term.

*Capital adequacy ratios*

1. **Bolivia’s banks report sufficient levels of capital to weather unforeseen shocks.** Contrary to the evolution in some neighboring countries, the capital adequacy ratios (CAR) showed a downward trend over the last years, but with around 12 percent remain overall solid (see Chart 8). The downward trend was mostly due to the strong deposit related growth of assets, which led to a stronger leverage of capital, and increasing levels of provisions, which lowered retained earnings. The current risk-weighted capital adequacy ratios are well above the 10 percent mandated by the regulatory framework and in line with international suggested levels of capital. Stress tests conducted conclude that banks have sufficient levels of capital to weather larger credit, interest rate and foreign exchange related shocks. The non-bank financial institutions also report solid levels of risk-weighted capital, with some of the savings and loan associations showing CARs of over 40 percent.

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| --- | --- |
| Chart 8: Capital adequacy – an international comparison and evolution (2005-2010, banks only) | |
|  |  |
| *Source: IMF Global Financial Stability Report and World Bank’s own calculations.* | |

|  |
| --- |
| Chart 9: Return on equity in 2010 |
|  |
| *Source: IMF Global Financial Stability Report and World Bank’s own calculation (last available, banks only)* |

*Profitability*

1. **Profitability levels in the banking sector recovered since 2004, and are now in line with international peers.** Having been close to zero in 2004, return on assets (ROA) and equity (ROE) increased again to over 1.7 and 16 percent in the banking sector. These ratios are currently slightly above regional averages, but in line with international levels, as can be seen in Chart 9[[49]](#footnote-49). The profitability in MFI- and commercial banks continues to be carried to a large extent by intermediation related income, with particularly the MFI banks still deriving 94 percent of their gross financial results through lending related income. However, over time non-intermediation related income has increasingly become important for the banking sector to sustain the levels of profitability. Foreign subsidiaries for example now achieve close to 80 percent of their income through foreign exchange related transactions and commissions for non-intermediation services (compared to 20 percent in 2005), and the public and commercial banks now derive around 50 percent of their income through non-intermediation commissions and sale of foreclosed assets.
2. **The banking system was able to enhance its efficiency over the years, but common efficiency indicators continue to be below its peers.** Operating expenses to assets in the banking sector came down from 4.5 in 2005 to now 4.2 percent, with in particular the microfinance banks showing significant improvements in their ratios over time (see Chart 10). This positive development helped bring Bolivia’s banks closer to ratios reported by regional and international peers. Cost to income ratios are also at the high end of the spectrum with over 70 percent. As will be discussed in more detail in Chapter 5, some of the lower efficiency are the result of the low population density, the high levels of informality in the economy, and deficiency in the financial infrastructure, which - together with recent efforts to expand coverage and measures taken by the government to reduce commission income for financial transactions - weigh on overall income and thus efficiency. Further enhancing efficiency will thus not only require additional efforts by individual institutions, but also hinge on further government supported reforms of the financial infrastructure.

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| --- | --- |
| Chart 10: Operating expenses to total assets – an international and domestic comparison | |
|  |  |
| *Source: ASFI and World Bank’s own calculation (international comparison for banks only)* | |

1. **Profitability and efficiency levels in non-bank deposit taking financial entities diverge strongly, with particularly cooperatives and savings and loan associations still showing room for improvements.** As for MFI banks, profitability in non-bank financial institutions hinges mostly on financial intermediation income through loans, but in some of the institutions is also supported by commission income through the handling of transactions for non-clients (such as for example the delivery of the cash transfer program *Renta Dignidad*, remittances and utility payments)[[50]](#footnote-50). Finance companies are in general profitable and have over the last few years significantly enhanced their cost to income and asset ratios. Compared to other microfinance institutions worldwide, they now show adequate efficiency indicators*.* On the other hand, savings and loan associations and cooperatives report low levels of ROE, which stem from high capital ratios in the case of savings and loan associations, lower lending spreads due to higher funding costs, as well as lower overall efficiency indicators in particular for the cooperative sector. The lower level of efficiency in cooperatives is not unusual in international comparison, as these institutions tend to be smaller and also provide additional services to their members, but could be enhanced through an improved organizational structure of the sector and the creation of second tier institutions such as regional or national cooperative centers or central banks (so called *Cajas Centrales)* which can bundle liquidity management, facilitate access to payment systems and also offer other outsourcing services for their members. The data for the savings and loan associations and cooperatives also suggests that efficiency and profitability gains could be reaped through consolidation to reach economies of scale or a broader regional coverage, and in the case of savings and loan associations also through a re-orientation of their business model towards a broader focus.

*Liquidity*

1. **The financial system is highly liquid.** As can be seen in Chart 11, the share of liquid assets steadily increased over the last few years, reaching a peak of 51 percent of assets in commercial banks between 2008 and 2009[[51]](#footnote-51). This is high in international comparison, and given the current interest rates offered on national and international bonds will likely negatively impact overall profitability[[52]](#footnote-52). It further suggests, as will be assessed in more depth in Chapter 6, that barriers to the provision of credit exist, that will have to be addressed in order to increase the level of financial intermediation. The excess liquidity is held in the Central Bank (i.e. around 16 percent for banks), other domestic financial institutions (i.e. 12 and 21 percent for open cooperatives and savings and loans associations), or in international assets (10 and 12 percent for commercial banks and open cooperatives). Liquid assets are sufficient to cover the short-term liabilities in all types of financial entities.

|  |  |
| --- | --- |
| Chart 11: Liquid assets to total assets – an international and domestic comparison of liquidity of the formal system | |
|  |  |
| *Source: ASFI and World Bank’s own calculation, which include entire formal systems.* | |

1. **While the high level of liquidity should over time be reduced, it currently nevertheless mitigates potential vulnerabilities arising from high levels of deposit concentration and the short-term nature of the funding sources.** The commercial banking sector shows high levels of depositor concentration[[53]](#footnote-53), and commercial banks and savings and loan associations report also report sight deposits of over 60 percent of deposits (compared to 40 percent in 2004) [[54]](#footnote-54). This leaves the entities vulnerable to sudden swings in depositor confidence, as for example seen during the recent deposit run in December 2010, which affected all types of institutions (see Text Box 1). The high level of liquidity in combination with the rapid response of the Central Bank and ASFI mitigated the effect of the deposit run. The experience also highlighted that it is in particular for the non-bank financial entities important (i) to provide direct, short-term access to liquidity support from the Central Bank for all financial entities, and (ii) to have more than one cash transport provider available that can quickly respond to sudden needs for cash, in particular outside of the largest cities.
2. **It should also be noted that the changes in the institutional composition of the pensions system can have a temporary impact on liquidity in the financial system, if not well sequenced.** Deposits by the private pension funds amount to around 20 percent of bank deposits, and are in general concentrated in a few larger commercial banks. The pension funds will in the future be managed by a public administrator, which could trigger a transfer of savings and term deposits into the public sphere[[55]](#footnote-55). This could lead to a re-shifting of liquid deposits from private commercial banks into the public *Banco Union*, and potentially trigger a temporary liquidity problem for the involved private banks during the transition if not sequenced appropriately.

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| Text Box 1: Recent experiences with bank runs in Bolivia  There have been two bank runs in the last year. Both runs were contained within 2-3 days given the overall solidity and high liquidity levels of the financial system, and measures taken by the Central Bank and ASFI.  The first was a brief run on one bank, after false rumors over the health of the institution surfaced. The other affected the entire financial system and was triggered by a variety of rumors in the context of the unrest that resulted by an increase in fuel prices, which leading to fears in the population over economic instability and a significant deterioration of the USD exchange rate. Overall, 3 percent of deposits were withdrawn at the end of December 2010, with a number of cooperatives, commercial banks and micro-finance institutions loosing up to 6 percent of their deposits in only 3 days.  Cooperatives, SLAs and finance companies that do not directly participate in the national payment system were particularly affected by this phenomenon, as they had to obtain liquidity through banks. The withdrawals mostly targeted USD deposits, with deposits in national currency seeing some increase and the overall number of depositors also remaining stable. Some of the deposits have in the meantime returned into the system, and no financial entity had to be intervened in as a result of the run. |

*Foreign exchange exposure*

1. **The reduction in dollarization levels of liabilities was matched by the reduction on the asset side, leaving the financial entities well within the limits for FX open positions determined by the regulatory framework[[56]](#footnote-56)**. According to the IMF, the exchange rate adjusted share of dollarized credits dropped from a crisis-induced peak in 2002 of over 90 percent to 60 percent in 2010 - the sharpest drop in the region (see Chart 12). This is a positive development, and the government should be commended for this achievement. Yet, a significant share of credit to the private sector continues to be denominated in foreign currency, with particularly the smaller enterprises and individual households being unlikely to generate foreign currency related income. This leaves the borrowers vulnerable to exchange rate fluctuations, and could create credit risk from unhedged borrowers, if the current appreciation of the Boliviano towards the US Dollar reverses. This would particularly affect the microfinance institutions as they tend to cater to micro entrepreneurs with limited foreign exchange related incomes.
2. **On the medium to longer term, the government might want to consider eliminating the recently introduced limits on total foreign investments as a share of capital**, as this limits the sector’s options for portfolio diversification and management of FX positions..The limits were introduced by the government to reduce the exposure of the financial system to developments on the international markets, and also to stimulate the internal credit market from the supply side. While these measures have in the current situation been successful in shielding the financial system from some of the international developments, credit growth hinges on a number of other demand and supply side aspects which are posing barriers to growth (See Chapter 6). Thus, the restrictions will likely only have a marginal effect on credit growth, but limit the entities’ potential to diversify sources of income and sustain lower lending rates.

|  |  |
| --- | --- |
| Chart 12: Foreign exchange exposure of balance sheet – by type of financial entity and international comparison | |
|  |  |
| *Source: ASFI and World Bank’s own calculations, which include entire formal systems.* | |

*Credit related indicators*

1. **Non-performing loans (NPLs) in all types of financial institutions have shown a downward trend over the last few years, bringing the NPLs in line with international comparison (see Chart 13)**. Regarding the institutional distribution of NPLs, the strongly diversified finance companies and MFI banks continue to show the lowest level of non-performing loans with around 1 percent, while a number of other financial entities still report ratios of 4 and higher due to past engagements in combination with a higher level of borrower and sectoral concentration[[57]](#footnote-57). As will be detailed in Chapter 6, the level of NPLs for productive loans continued to be higher than those shown by the loan portfolios granted for commerce or services, although showing signs of improvement.[[58]](#footnote-58)
2. **Most financial entities have used the solid profitability over the last few years to stock up their levels of provisioning**. Supported also by enhanced risk-based supervision, coverage levels increased from between 60-100 percent in 2005 to well over 100 percent for all types of financial entities, and for the system as such are now adequate. However, a few of the commercial banks and some of the larger SLAs show insufficient levels of coverage if based on the risk classification of borrowers and not on the actual non-performing loans.

|  |  |
| --- | --- |
| Chart 13: Non-performing loans and provisioning levels by type of institutions[[59]](#footnote-59) and international comparison | |
|  |  |
| *Source: Source: IMF Global Financial Stability Report, ASFI and World Bank’s own calculations (first chart for banks only)* | |

1. **Going forward, lending standards should be carefully monitored to prevent over-indebtedness of clients and negative repercussions on financial soundness indicators in the wake of a significant credit expansion.** The increased market competition in combination with high liquidity levels, limited investment options and moral suasion efforts by the government provides strong incentives for the financial entities to seek new clients and market niches, and has triggered stronger credit growth since 2010. The number of loans per borrower increased from an already high 3.6 loans in 2006 to 4.1 loans in December 2010, contributing to an increase in average loan values per borrower. Financial entities in particular increased their consumer loan portfolio, reaching a share of 11 percent of total loans compared to 8 percent in 2005. Savings and loan associations and cooperatives increasingly cater to borrowers with loans over USD 30,000, while some commercial banks went down-market and increased their loan base between USD 1,000-30,000. Lending to new client segments implies increased risk, requiring usually adaptations to existing lending techniques, and needs to be carefully monitored by the supervisory agency in its initial stages. Furthermore, risk management standards for existing markets need to be maintained and sporadically monitored by ASFI, in particular for the housing market, which is experiencing a period of strong growth, and for the productive sector, for which a number of incentives are currently being put in place to increase lending.
2. **The higher level of competition has contributed to a reduction of the lending interest rates for all types of clients**. For example, mortgage loans are now being offered for 4 percent interest rates by banks and savings and loan associations, and microcredit and consumer credit at rates between 8 and 22 percent per annum (see also Chapter 6). Currently, the rates on some loans are negative in real terms. Such rates are unlikely to be sustainable in time, as they lead to a decapitalization of the depositors and of the financial entities. Unduly low rates furthermore have the effect of increasing the willingness of borrowers to take loans beyond their payment capacity to take advantage of existing market conditions. This is particularly problematic in the case of long-term loans with adjustable interest rates, which can quickly lead to repayment problems when the interest rates increase.

# The regulatory and supervisory framework for the financial sector

*The government introduced a number of reforms to the regulatory framework over the last few years to further increase its compliance with the Basel Core Principles (BCP), while maintaining - with a few exceptions - a regulatory level playing field between the players operating in the market. Some issues arise through recent efforts to use the regulatory framework for political measures, the frequency of changes, as well as the comparatively high regulatory burden associated with the regulatory framework per se, which all impose significant costs in particular on the smaller entities. Finally, the supervisory capacity of ASFI is stretched with the number of entities it has to supervise, and recent efforts to incorporate closed cooperatives and IFD into oversight should be accompanied with an increased budgetary envelop, as well as a broader technical assistance effort and incentives to facilitate the transition of the entities.*

1. **The regulatory framework for banks and non-bank financial institutions is largely identical, and in general provides a level playing field for the financial sector and for the entry of new players**. The authorities should be commended for this. Most prudential regulations such as capital adequacy ratios, provisioning levels, minimum reserve requirements, and foreign exchange limits apply to all types of financial entities, and as such levy similar costs on the market players. While there are a number of restrictions in place with regard to operations that can be performed by non-bank financial institutions[[60]](#footnote-60), these are not unusual and with the exception of the restrictions on issuing current accounts and credit cards, as well as investments in auxiliary service providers don’t appear to limit the development of individual players. As in many countries, specialized credit institutions are generally not allowed to offer current accounts and credit cards, which can negatively impact competition through lower funding costs for banks over their non-bank competitors, and provide an advantage for banks over clients with export / import business.
2. **While a regulatory level playing field is positive overall, some differentiation might be warranted for cooperatives, in particular with view to the incorporation of the small closed cooperatives into the regulatory framework.** The capital requirement of USD 150,000 for cooperatives will at least for the short term be a problem for some of the smaller closed cooperatives, and unless replaced by a staged approach (or one that does not require cooperatives below that threshold to comply with regular prudential regulations) might require some consolidation on the sector or lead to non-compliance. Cooperatives also face restrictions with regard to outsourcing of services. Articles 108 and 109 of the Cooperative Law explicitly allow second tier institutions for cooperatives, but restricts them to the same region or province, which can be a considerable limitation given the sparse coverage with cooperatives in some areas and the advantages of diversifying geographically. Furthermore, the regulations issued by ASFI only allow an investment of 20 percent of a cooperative’s capital in another entity, which can pose a significant hurdle for reaping economies of scale through outsourcing of services such as internal audit and accounting for small entities. With regard to the exposure limits, cooperatives find it generally hard to fill core management and oversight positions as this precludes the respective person from receiving any form of credit through the cooperative. Finally, as discussed in general, particularly the daily information requirements appear onerous, and in some of the locations difficult to comply with, as there is no on-line connectivity.
3. **Since 2004, significant progress was achieved in upgrading the regulatory framework and enhancing risk-based supervision.** Financial oversight for the various financial players was consolidated into one large supervisory agency, ASFI, which reduced overlapping mandates and enhanced clarity and transparency in the oversight. Furthermore, new regulations for credit, liquidity and foreign exchange rate risks were passed and adequate provisioning levels enforced, which improved the quality of risk management in the financial system. On and off-site supervision benefited from the introduction of a new supervision manual for on-site supervision, and further upgrading of the quantity and quality of data received from the supervised entities. These reforms brought the supervisory framework in Bolivia further into compliance with the Basel Core Principles (BCP).
4. **Bolivia also has already a number of norms and regulations in place to protect the client from unfair practices in formal financial institutions**. The regulations pertain to providing information in a transparent and fair manner, the right to receive quality service and access to dispute resolution mechanisms. The regulations eliminate for example commissions on basic services such as monthly account maintenance fees and credit processing, limit waiting times in branches to 30 minutes, and mandate the provision of small bills in ATMs. The regulations in place are very advanced and in many regards follow international best practice, but in some aspects impose a large burden and cost on the financial institutions and as such have turned into a barrier for increasing outreach. As will be discussed below, some of them could be revised without compromising the protection of the client in a significant way.
5. **The sheer number and frequency of changes in regulations over the last few years levied additional costs on entities to follow and implement the changes and introduced an element of uncertainty about the overall direction of the framework.** In 2010 alone, over 30 circulars were issued, regulating topics of consumer protection, information requirements, foreign exchange limits and controls, provisioning rules as well as modifications to recent regulations on IFDs, closed cooperatives and the second tier development bank. The frequency of changes implies costs for the entities, which have to monitor them, translate them into daily practice and also adapt their systems – costs that in particular smaller entities without a well functioning representation will find difficult to bear.
6. **Some of the changes have also been driven by policy considerations and not stability concerns.** Examples of this include the regulations to stimulate credit to the productive sector[[61]](#footnote-61), as well as consumer protection and regulations to enhance the outreach of the system in rural areas and service to low-income segments of the population. Changes of this nature introduce conflicts towards the objective of safeguarding the stability of the system, and should only be used in exceptional circumstances (if at all). The government might want to refocus its reform efforts on other – potentially more effective – instruments to promote financial sector deepening, such as setting positive incentives through partial credit schemes, promoting access to finance within value chains, and the way it handles its Government to person payments, or through tax incentives and moral suasion. This would leave prudential oversight to foster the system’s stability as ASFI’s sole objective.
7. **The authorities are currently working on a new financial system law to bring the legal framework in line with the new Constitution. This provides a good opportunity to address remaining issues** **and bring stability to the framework.** As the recent FSAP update has already provided an in-depth assessment of the regulatory framework in comparison to the Basel Core Principles, the following bullets will only highlight some additional issues, which are of particular relevance for the deepening of the financial system as well as the transformation of the unregulated financial entities into regulated entities[[62]](#footnote-62):

* **Overall, a careful weighing of the costs of regulation compared to the added security they bring to the overall stability of the system and the protection of the customer should be undertaken**. As will be discussed in more detail in Chapter 5, reaching out to rural areas will critically depend on lowering costs of service delivery. Security standards prescribed through the regulatory framework can add significant administrative burden and costs on an entity, and lower incentives for enlarging the branch network or using non-bank agents for service delivery. The same holds for consumer protection measures where for example having a SARC (*Servicio de Atención de Reclamos de los Clientes,* recently changed into *Punto de Reclamo*) representative in small remote branches with a limited number of staff and the tracking of client waiting times increases the net costs, while elimination of commissions reduces potential sources of income to compensate for the necessary upfront investment and ongoing costs. More details on measures that could be alternatively introduced are included in Chapter 5.4.
* **To facilitate sound and equitable growth on the supply side, some regulations should be revised or added to differentiate the regulatory requirements for non-bank deposit taking institutions, and facilitate the reaping of economies of scale and improve governance standards.** For example, the capital restrictions for investments in auxiliary service providers such as *Cajas Centrales* could be made more flexible by introducing case to case approval, or allowing in general a higher investment limits in directly linked second tier service providers. Exposure limits for managers in cooperatives can be adjusted through the setting of clear limits for such loans in percent of the entities capital, and also introducing separate credit decision mechanisms for those credits. With regard to the issuance of credit cards, the regulatory framework and supervision can pay for example a stronger attention on ensuring adequate risk controls and limiting the lending in line with the size of the financial entity, as done in Costa Rica. Furthermore, a code of good governance and its implementation should be considered for cooperatives to reduce governance problems in the sector[[63]](#footnote-63). In developing regulations it is important to maintain close collaboration with the industry in order to increase ownership, weigh costs and benefits of new regulations, and enhance the effectiveness in implementation.
* **To enhance access to credit for enterprises and individuals, regulations need to be furthered to allow new products and more flexibility in lending conditions**. As will be discussed in more depth in Chapter 6, the new legal framework should pass / amend laws and regulations for leasing, factoring, partial credit guarantees, and registries to make these operational or broaden their applicability. For leasing, a new law should for example allow leasing operations to be conducted within a financial institution and not as currently foreseen through a separate entity, and allow all types of credit institutions to offer leasing and factoring products. A draft law on leasing has already been prepared in earlier years, and might be used as a basis for this work. The existing regulations on collateral would need to be amended to broaden the definition of what constitutes movable collateral, and set up clear and harmonized institutional registry structures[[64]](#footnote-64). As reforming collateral regimes would necessitate amendments to a number of laws, including the commercial code and labor code, the authorities might consider issuing a separate framework law on guarantees similar to the one already developed in 2006, which would override other applicable norms and regulation. It is important that the framework law also addresses creditor rights, as taking collateral without being able to enforce it would be counterproductive. Finally, with regard to factoring, the commercial code needs to establish what constitutes an invoice for factoring to become feasible.

1. **Bolivia is the only country in the region that aims to bring all closed cooperatives and IFD, regardless of their size, under the full prudential oversight of the financial sector authority. This not only implies high supervision costs but also might require some consolidation of the sector.** While the asset size of the sector does not suggest that the closed cooperatives are of systemic importance, they however cater to a large number of depositors, mostly from lower income segments of the population and in rural areas. Bringing them under supervision to monitor stability of the sector per se is thus a positive step. To facilitate the transition and also rationalize scarce supervision budget, ASFI might want to consider introducing a stronger differentiation in the applicable regulatory framework along size of assets as well as in the actual supervision along risk-based considerations. The differentiation could include, in the case of the smaller entities, fewer reporting requirements (both in quantity and frequency, and form of media used to allow cooperatives in remote areas with limited ICT infrastructure to comply)[[65]](#footnote-65), less stringent minimum capital requirements, and lower frequency of supervision[[66]](#footnote-66), but also additional restrictions on the type of activities allowed. Other countries in the region for example only mandate formal supervision after a threshold of capital is reached, or focus on the capital adequacy ratio instead of a minimum capital requirement. Finally, it is important to improve the available data on the sector, and clarify the role of the two involved supervisory agencies, the ASFI and the *Dirección General de Cooperativas* with regard to licensing, merging and liquidating / closing of cooperatives, as well as training, data collection and oversight.
2. **The transition of closed cooperatives and IFDs to become supervised entities needs to be carefully staged and sufficient incentives and support to the institutions provided to facilitate the process.** Experience from other countries suggests that the transition process per se is difficult as not all unregulated financial entities see the rationale for entering into the process, or simply do not have the size, financial and human capacities to adhere to the added information and institutional requirements. A number of factors can facilitate the process, and could be considered for implementation in Bolivia:

* **Establish clear but realistic deadlines for the transition, provide a roadmap for the transition process with specific targets and develop a clear and enforceable set of sanctions for non-compliance.** Considerations should be given to sequencing the process by initially focusing on the larger unregulated players, and addressing the transformation of the smaller entities at a later stage or at a slower pace. By setting unrealistic deadlines, or in the absence of enforcement power in case of non-compliance, the respective regulatory authority looses credibility and traction. Sanctions could for example include setting of action plans, restrictions on the type of operations to be conducted, replacement of Board or management, and in a last instance merger or closure of the entity in case of non-compliance. In this context it is advisable to reinstate the immunity of prosecution for ASFI staff, so that interventions into failing entities can be carried out without negative consequences for the involved staff.
* **Provide technical assistance to individual institutions and to the federations** to enhance their technical capacity, and design and implement action plans for institutional development as well as address targeted technical needs during its implementation. Ideally, the assistance should be provided on a cost-sharing basis.
* **Give incentives for attaining different stages in the transition process**. This could for example include insertion into a deposit insurance scheme after a certain level of quality of information and financial soundness is achieved, as well as issuance of subordinated debt to increase capital levels, reimbursement for some of the training or technical assistance costs shouldered by the entity in case of speedy implementation of reforms, access to external funding sources such as government or donor funds, and access to the payment system along the reform process. Furthermore, media campaigns to educate the population of the transformation, and the establishment of “solidity” grades that can be perceived by the public, such as their participation in a deposit guarantee scheme or participating in the payment of conditional cash transfers for the government could – if done in a targeted way – be used as a positive incentive.

1. **The additional task of incorporating a large number of the hitherto unregulated financial entities into prudential oversight will stretch ASFI’s capacity to supervise the financial system further.** ASFI already has a considerable task to muster with the supervision of the existing formal financial institutions, and the low public salaries affect ASFI’s capacity to hire and retain adequate human resources. ASFI is now also providing substantial support and technical assistance to the closed cooperatives and IFDs in transition, and is developing a consumer protection and education program, both of which need to be accompanied with an alignment of resources, human and institutional capacity and processes to the growing responsibilities. Attention has to be paid to adjust the budgetary envelop of ASFI in line with the new tasks, and throughout the transition process adjusted. In the medium term and assuming a considerable strengthening of the organizational structure of the cooperative sector, thought could be given to using auxiliary supervision for smaller entities, as it is done in Mexico and other countries.

# Barriers to financial inclusion, in particular in rural areas

*Supported by government reform efforts, the number of financial service points increased significantly over the last few years, but mostly in the form of more traditional and costly branch networks. Covering the remaining areas with financial services will be more difficult, as the low population density, higher poverty rates, as well as some deficiencies in the available ICT and financial infrastructure raise the cost of service delivery at the rural level. Furthermore, lack of financial education and the prevalence of cash transactions lower the demand for more efficient payment services such as electronic payments and make the implementation of cheaper modern service delivery channels such as non-bank agents more difficult. To foster financial inclusion and enhance the coverage with financial access points throughout the country, the focus has thus to be on reforms to lower the costs of service delivery, and, combined with marketing and promotion campaigns, to stimulate the uptake of more efficient payment options by the population.*

## Structural aspects

1. **There are a number of long-term factors that set the stage for a financial system’s overall ease of providing access to financial services to a broader share of the population.** One of these factors is the overall level of development (typically measured by per capita income), which together with the distribution of income (typically depicted by the Gini coefficient and survey results on poverty) provides an indication on the share of the population that is considered “bankable” on various levels. Another factor is the population density and the share of the population living in rural areas, both of which impact the costs and possible economies of scale for delivering financial services to more remote areas. Finally, the level of available information and communication technology determines to what extent modern technologies can be used to lower costs for the delivery of financial services.
2. **Despite solid economic growth rates over the last few years, Bolivia still has some gaps to bridge with regard to structural factors that facilitate financial access.** Income per capita increased by 29 percent between 2005 and 2009 due to the favorable economic situation, but income inequality and levels of poverty continue to be on the higher side. Based on available World Bank statistics, 10 percent of the wealthiest citizens hold more than 45 percent of the income, a figure that is comparatively high for both neighboring and comparator countries. This inequality in income is reflected in the Gini coefficient, with Bolivia showing the highest inequality in the region after Colombia (see Chart 14). The share of the population that fits the traditional profile of “bankable clients” is thus likely lower in Bolivia than in other countries of the region and income bracket.
3. **Employment in the rural sector - as in many countries - is dominated by small-scale agriculture, with a large share of the population being poor.** Based on data from INE, around 40 percent of the population lives in rural areas[[67]](#footnote-67), of which 3/4 depends on the agricultural sector as their main source of income[[68]](#footnote-68). The sector contributes currently around 14 percent to GDP and is exposed to considerable vagaries of weather. Agricultural output strongly fluctuates, leading to unstable levels of income. A reported 77 percent of people in rural areas are considered to be poor, 35 percent extremely poor (see Chart 14). Remittances, accounting usually for around 6 percent of GDP per year, play an important role in bridging gaps in income of the recipients and helps smooth their consumption.

|  |  |
| --- | --- |
| Table 7: Municipalities in Bolivia by inhabitants | |
| Over 1 million | 1 |
| 500,00 – 1 million | 3 |
| 100,000 – 499,999 | 6 |
| 50,000 – 99,999 | 6 |
| 10,000 – 49,999 | 27 |
| Below | 284 |
| ***Total municipalities*** | ***327*** |
| ***Total locations*** | ***14,000*** |
| *Source:INE* | |

1. **Bolivia is one of the least densely populated countries in the world, which increases the costs of providing services in more remote areas.** Bolivia has on average 9 inhabitants per km2, compared to neighboring countries such as Paraguay, Chile and Peru with around 20, and countries like Mexico, Kenya, Honduras and Senegal with around 60 inhabitants per km2. About half of the population lives in the 16 cities with more than 50,000 inhabitants, while the remaining population is thinly spread out amongst the other 311 municipalities (see Table 7). Of the latter, close to 90 percent have less than 10,000 inhabitants and are thus very small. The municipalities themselves are sub-divided into 14,000 small localities, the majority of which have less than 1,000 inhabitants. Offering financial services in those small and remote localities with the traditional branch based approach is difficult to do in a financially self-sustainable way.

|  |  |
| --- | --- |
| **Chart 14: Overview over long-term indicators that can impede financial access in a country** | |
| *Bolivia has the lowest per capita income in the region and income is distributed comparatively uneven within the population.* | |
|  |  |
| *An estimated 20 percent of the population is living in poverty, a large share of which in rural areas.* | |
|  |  |
| *The population is thinly spread across the country, making it costly to service them, and coverage with phone services is low.* | |
|  |  |

Source: *World Bank data, 2008*.

1. **The communication and roads infrastructure in the country is not yet sufficiently developed, making coverage with modern financial services more difficult in remote areas.** One of the core issues mentioned by many financial institutions with regard to providing services on the rural level is the lack of ICT infrastructure. In many instances, telephone or Internet services are not available or not yet sufficiently reliable and fast for the transmission of data files. For example, only 45 percent of the population was covered by one of the mobile cellular networks in 2007, compared to over 90 percent in most other countries in the region or income bracket[[69]](#footnote-69). For opening a branch, or using non-bank agents, the financial entities thus need to install expensive satellite dishes[[70]](#footnote-70) to be able to process transactions on-line or transmit information to the main branch for compilation purposes. The public telecommunications company and the two larger private mobile phone providers are already undertaking broader efforts to increase coverage in rural areas, but the limitations in the ICT infrastructure will likely continue on the short to medium term to incur higher costs for outreach. Similar bottlenecks exist with regard to roads, where according to available World Bank data only 62,000 km of road network are available – on of the lowest in the region and by far the lowest if taken the size of the country into consideration. Only 6.7 percent of the roads are paved, and reports are frequent that even main routes are not passable during or after heavy rain. This makes outreach more difficult and costly.

## The available financial infrastructure

1. **Additional to those longer-term factors, the availability of adequate financial infrastructure also plays an important role for financial sector deepening.** A well functioning retail payment system, to which a broad variety of financial institutions and non bank agents have access, can facilitate the delivery of financial services (including remittances and government transfers), lower the risk involved with using non-traditional delivery channels such as non-bank agents and mobile banking solutions, and in combination reduce the costs of service delivery from the supply side. This can contribute to making outreach to rural areas “affordable” for financial institutions if demand for services exists. The government can support reforms of the financial infrastructure in many instances directly, through for example reforms of the regulatory framework for branchless banking and reforms of the retail payment system infrastructure, and also facilitate outreach through the way it channels its government to person and business payments. These reforms usually help foster outreach on the short to medium term. The following paragraphs will assess to what extent the necessary financial infrastructure is in place.

***Usage of “traditional” and” non-traditional” service points***

1. **As discussed in Chapter 2, the number of financial service points in the formal financial sector increased significantly over the last few years, but mostly in the form of more traditional branch networks.** Between 2007 and April 2010[[71]](#footnote-71),service points of the formal financial system increased by around 45 percent to a total number of 1290. The strongest growth came from microfinance banks (see Table 8), who more than doubled their service points between December 2007 and April 2010. Microfinance banks and finance companies set up a number of full branches in new locations, and also strongly invested into setting up “*cajas externas*” and “*ventanillas*” as cheaper additional service points for financial services or in some instances to pilot new locations. Banks and cooperatives on the other hand mostly expanded through the installation of less costly “*agencias fijas*” and “*cajas externas*”[[72]](#footnote-72), which are forms of smaller satellite branches within or close to localities in which the respective financial entity is already present. While these smaller bank - operated service points help bring down the costs of service delivery, they however still involve significant investments in installations (i.e. for communication infrastructure as discussed above), security and human resources, and thus will require a more elevated volume of transactions to be financially viable. Given the low population density in Bolivia, the number of localities in which these types of branches are viable will therefore be limited and saturation in some municipalities can already be observed[[73]](#footnote-73). The still unregulated IFDs and closed cooperatives also have a significant branch network (330 and 128 branches respectively, equivalent to 35 percent of formal sector branches). However, the available data is not sufficiently detailed to understand the type of service point used and the evolution over time, and likely also does not yet include small closed cooperatives which operate in rural areas and have not yet initiated the transition process.

Table 8: Evolution of service points in the formal financial system

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | **"Traditional" forms of branches** | | | | **Innovative service points** | | | | **Total** | |
| ***Oficina Central*** | ***Sucursal*** | ***Agencia Fija*** | ***Caja externa*** | ***Oficina Ferial*** | ***Manda-to***  ***(Agent)*** | ***Venta-nilla*** | ***Agencia Movil*** |
| **Banks** | Dec-07 | 13 | 49 | 285 | 10 | 0 | 34 | 23 | 0 | 414 | 47.7% |
| Apr-10 | 13 | 59 | 358 | 127 | 2 | 40 | 22 | 1 | 622 | 48.2% |
| *foreign subsidiaries* | Dec-07 | 3 |  | 1 |  |  |  |  |  | 4 | 0.5% |
| Apr-10 | 3 | 1 |  |  |  |  |  |  | 4 | 0.3% |
| *commercial banks* | Dec-07 | 6 | 33 | 161 | 10 |  | 34 | 10 |  | 254 | 29.3% |
| Apr-10 | 6 | 34 | 209 | 39 | 2 | 40 | 15 |  | 345 | 26.7% |
| *MFI banks* | Dec-07 | 2 | 9 | 84 | 0 |  |  | 13 |  | 108 | 12.4% |
| Apr-10 | 2 | 17 | 108 | 86 |  |  | 7 | 1 | 221 | 17.1% |
| *public bank* | Dec-07 | 2 | 7 | 39 | 0 |  |  |  |  | 48 | 5.5% |
| Apr-10 | 2 | 7 | 41 | 2 |  |  |  |  | 52 | 4.0% |
| **SLAs** | Dec-07 | 9 | 5 | 24 | 2 |  |  | 15 |  | 55 | 6.3% |
| Apr-10 | 8 | 2 | 25 | 3 |  |  | 11 |  | 49 | 3.8% |
| **Finance Companies** | Dec-07 | 5 | 12 | 173 | 50 |  | 4 | 54 |  | 298 | 34.3% |
| Apr-10 | 6 | 27 | 282 | 73 | 19 |  | 83 |  | 490 | 38.0% |
| **Open Cooperatives** | Dec-07 | 23 | 6 | 62 | 2 |  | 2 | 6 |  | 101 | 11.6% |
| Apr-10 | 24 | 7 | 78 | 12 |  | 2 | 6 |  | 129 | 10.0% |
| **TOTAL** | Dec-07 | 50 | 72 | 544 | 64 | 0 | 40 | 98 | 0 | 868 | 100% |
| Apr-10 | 51 | 95 | 743 | 215 | 21 | 42 | 122 | 1 | 1,290 | 100% |

*Source: Compilation based on data from ASFI.*

1. **Innovative and less costly outreach points are also piloted, but lack of knowledge and trust of the population and the complex regulatory framework reportedly impede a stronger roll out.** To a limited extent, innovative service points such as service windows at weekly markets (so-called “*oficinas feriales*”), mobile branches and non-bank agents (so called “*mandates”*) are being used, but the experience from financial institutions points to barriers in the uptake of those models by the population (see demand side barriers discussed below), as well as substantial costs due to the prevailing regulatory framework which make implementing some of these models less attractive[[74]](#footnote-74).
2. **There is no indication that larger chains such as supermarkets, or other retail chains exist throughout the country, which could provide easy cooperation points as non-bank agents to increase geographic access.** The lack of larger chains makes establishing those agent models more costly, as agents need to be identified individually, contracts and the infrastructure requirements developed for a potentially diverse set of agents, as well as marketing campaigns launched to promote the use of those innovative delivery channels. Furthermore, surveillance of the correct functioning of the non-bank agent has to be done solely by the financial institution, and cannot be assumed jointly by the headquarters of a chain and the financial institution.
3. **Bank-based mobile banking platforms are starting to emerge, and could provide another alternative for accessing financial services in the medium term.** At a few banks, clients can already use their cell phones to pay bills and check balances, and other financial entities offer Internet banking. These services are used by some urban clients, but in general have not yet led to an increase in outreach to new clients. The state-owned telephone provider ENTEL is currently working on developing a transactional platform for financial institutions to allow bank clients to conduct banking transaction from their account via their ENTEL cell phone. To what extent those models will be an additional viable option for rolling out financial services to hitherto unbanked segments of the population will strongly depend on the actual marketing and targeting of mobile banking services by the financial sector, as well as the relevance of the offered financial services to the population. There appears to be some interest in those models emerging, but implementation will likely take time and some prior piloting.
4. **Experience in other countries shows that branchless banking solutions come with a considerable saving for the client and the financial institution**. The client saves time and transportation costs for traveling to the next service point, and frequently also pays less for the service itself[[75]](#footnote-75). Delivery costs of financial institutions are also lower than in the case of traditional channels (the Consultative Group of the Poor (CGAP) suggests branchless banking services are overall 38 percent cheaper than traditional models). Being able to make payments anywhere also significantly facilitates the development and integration of value chains, with a case study on Tanzania for example showing that mobile payments can lead to faster end-to-end processes, and an increase in asset turnover.

***Payment system infrastructure***

1. **With regard to financial service specific infrastructure, the transport of cash is expensive in Bolivia.** Much of the economy is cash based, and financial institutions have to manage larger amounts and fluctuations in cash as a result. So far, only one transport company operates in Bolivia, enjoying a de facto monopoly with its 9 branches and around 100 armored vehicles throughout the country. Several interviews indicate that costs for the delivery of cash are high, service capacity is limited (as shown in particular during the recent run on deposits) and only an insufficient number of locations are being serviced. This leaves the risk of cash transport in the remaining locations to the financial entity. To facilitate the licensing of additional money transport providers and stimulate competition, ASFI recently incorporated money transport companies into its regulatory sphere[[76]](#footnote-76), and is in the process of drafting regulations to clarify the procedures and core requirements for obtaining a license. FINRURAL and ASOFIN are already in advanced stages of preparation for the launch of an additional service provider, as is one of the two card payment switches. These reforms should lead to a significant drop in costs at least on the medium term.
2. **The large value payment system infrastructure is fairly advanced but only a limited number of supervised financial entities are directly connected to it.** Reforms since 2002 created a Real-Time Gross Settlement System (RTGS) at the Central Bank as well as a unified Treasury Payment System in which government payments are being processed. However, only banks, 4 finance companies and 3 clearing houses are direct accessing the RTGS[[77]](#footnote-77), while cooperatives, savings and loan associations, 2 finance companies and also one of the card network operators are not yet directly participating[[78]](#footnote-78). NN The lack of direct access contributes to higher costs for non-participants for settling electronic transactions with other institutions, and also has a negative impact on liquidity management and ease of receiving cash[[79]](#footnote-79). In consequence hereof, the entities that do not participate in the RTGS had significant difficulties to access cash during the recent run on deposits. Incorporating these entities into the RTGS will be an important measure that could contribute to the overall stability of the financial system.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Table 9: Evolution of ATMs by type of financial entity | | | | |
|  | **Dec-07** | **Apr-10** | **Growth** | **Share of total** |
|
| **Banks** | 719 | 967 | 34% | 85% |
| *foreign subsidiaries* | 1 | 1 | 0% | 0% |
| *commercial banks* | 594 | 772 | 30% | 68% |
| *MFI banks* | 41 | 98 | 139% | 9% |
| *public banks* | 83 | 96 | 16% | 8% |
| **SLAs** | 14 | 25 | 79% | 2% |
| **Finance Companies** | 64 | 115 | 80% | 10% |
| **Open Cooperatives** | 9 | 36 | 300% | 3% |
| **TOTAL** | 806 | 1,143 | 42% | 100% |
| *Source: ASFI.* | | | | |

1. **In the retail payment system, oligopolistic tendencies lead to a fragmentation of the system and contribute to a low uptake of electronic payment transactions by the end-user.** According to the current regulation, only banks are authorized to issue checks. State of the art check- and electronic transfer clearinghouses are available to banks through *Administración de Cámaras de Compensación y Liquidación* (ACCL, housed in the Association of Private Banks, ASOBAN), while non-bank deposit taking institutions settle cross-institutional transactions via their accounts held at banks. Depending on the commissions charged by the corresponding bank, this can be costly and cannot be passed on to the end-user due to regulatory restrictions on commissions. There are also two large credit and debit card networks operating in the country, *ATC* and *Linkser*. These two networks are owned by a consortium of 4 and 3 banks respectively, and are interlinked. The ownership structure led to significant differences in the cost of using the network infrastructure between participating banks and other financial entities[[80]](#footnote-80). Combined with existing restrictions on charging commissions on the services provided, it de facto discourages the promotion of payment cards by non-banks. Furthermore, in the absence of demand from clients and due to prevailing oligopolistic structures in the payment system infrastructure, the financial institutions until recently did not invest into setting up a broad ATM and POS infrastructure, leading to a low number of ATMs particularly in the microfinance institutions: MFI banks, finance companies and cooperatives account for over 50 percent of all deposit accounts in the financial system, but their share in ATMs is only 22 percent (see Table 9).
2. **Given the high costs of using the existing retail payment system infrastructure, non-participating financial institutions and a data platform provider have started developing their own payment network.** The cooperative system is setting up a debit card based payment network through *Linkser*, which will be interoperable with the other systems and provide real-time clearance within the cooperative sector[[81]](#footnote-81). The system also aims to incorporate remittances services, and is currently piloting this module. The micro-finance associations ASOFIN and FINRURAL are working on setting up a transactional switch, potentially using smart cards. In addition to these broader initiatives, individual institutions have or are developing their own ATM network and card systems, as the costs involved for developing and operating own payment platforms can be quickly amortized due to cost-savings reaped in comparison to using the comparatively expensive available infrastructure. Most of the cards in the system are equipped with a magnetic stripe, but pilots with smart cards are being conducted to overcome the lack of connectivity in remote areas. Finally, *Sintesis* - a data platform operator which is already providing the data platform for channeling of conditional cash transfers through financial entities – is in the process of setting up a transactional platform for processing of remittance, utility and general payment transactions, with the settlement of the transaction foreseen to be done through the national payment system infrastructure. The development of these individual initiatives is a positive development, as it will increase competition, and hopefully lead to a stronger push into automating payments from the supply side.

## Demand side factors

1. **A significant share of the population already uses the financial system for transactional purposes, but most of the transactions do not involve a more permanent bank-client relationship.** Lack of knowledge about the advantages of using electronic payment options on the part of the population, gaps on the supply side as well as a general more risk averse approach towards financial institutions due to earlier bad experiences during financial crises and a perception of higher fraud in the payment with cards lead to a strong reliance on cash as sole means of payment:

* **92 percent of the remittances are paid out in cash, with the remaining being paid into accounts.** Remittances are an important source of income for many Bolivians, and in percent of GDP account for over 6 percent. Based on a recent report by CEMLA, IADB and FOMIN (2010), close to 70 percent of all remittances are channeled on the Bolivian side through regulated financial entities, mostly banks[[82]](#footnote-82), but get cashed out to the end-beneficiary upon delivery. Survey results for the CEMLAC / IADB / FOMIN study show that microfinance institutions have a higher occurrence of paying out remittances via accounts, indicating a stronger effort by those institutions to bank those clients, but even in these institutions cash-out dominates by far.
* **Cash transfer programs from the government are also to a large extent delivered through the financial system, but all get paid out directly in cash.** The *Bono Juana Azurduy*, which is supporting pregnant mothers and newborns, is in its entirety delivered through the 33 participating financial institutions. The other two larger government transfer programs, the *Renta Dignidad* and the *Bono Juancito Pinto*, also use for the vast majority of payments the financial system, with only remote locations being catered to by the armed forces. The conditional cash transfer payments are being made in cash, regardless of whether the beneficiary has an account or not.
* **Finally, payment of utility bills is also routinely done via financial entities, which receive a universally agreed commission from the utility provider for this service.** Most of the interviewed people reported either traveling personally to the nearest financial institution to pay the bills in cash (despite having a deposit account), or sending a person of trust from the village once a month to the next larger city.

1. Having to go to a financial service point for making a payment or receiving funds is a considerable loss of efficiency for the client, as it implies traveling costs and time that could be used for more productive purposes.
2. **The lack of knowledge and existing customer preferences make deploying electronic payment options and innovative delivery channels more difficult**. Random supply and demand side discussions indicate that clients use their deposit accounts for storing surplus funds or saving for a particular purpose, but manage their payment transaction via direct cash payments[[83]](#footnote-83). Financial institutions and utility companies reported that efforts to increase the number of direct debits were not successful, as the population was either not familiar with this, preferred using cash to manage their budget and pay whenever sufficient funding was available, or wanted to delay payments to the last moment. Similar experiences were reported from companies and government institutions with regard to the payroll. Most of the salaries are still paid in cash, as employees – if left with a choice - prefer cash over having the salary directly deposited into an account - even if they already have an account.
3. **Finally, accessibility and ease of doing transactions also play a role for the uptake of a financial service provider in remote areas, but it is the trust that seems to be the driving factor of success**. An assessment of a pilot operation by *Financiera Prodem* (2003) showed that a substantial amount of savings can be generated in poor rural areas, but success in attract savings and promoting other services hinges on the aura of trust and confidence that a financial institution manages to establish in a location[[84]](#footnote-84).

## Moving ahead – Possible options for increasing financial inclusion, in particular in rural areas

1. **There are already a number of government reform initiatives emerging or underway, which aim at furthering outreach with financial service points.** Since 2009, ASFI introduced new regulations on service points, including mobile branches and also further clarified the characteristics and products offered under existing servicing points such as temporary branches at market places (so-called “*oficinas feriales”* and “*oficinas externas*”) in rural areas. Furthermore, ASFI introduced annual performance targets for financial entities with regard to opening of service points in hitherto underserved geographic locations, and developed a sophisticated coverage map and model. The fulfillment of those performance targets is a precondition for being allowed to open service points in other areas. Supported by the World Bank, one of the conditional cash transfers is now channeled in its entirety through the financial system. Finally, ASFI has created a dedicated unit for consumer protection and financial education, which developed courses, seminars and publications to foster financial education and so far has reached out to over 3,300 people of different social and cultural backgrounds with their training units. While these reforms move into the right direction, the regulatory framework however imposes significant costs for security standards and consumer protection related measures on the financial entities, thus providing conflicting incentives with regard to outreach[[85]](#footnote-85). Finally, Banco Union is also aiming to enhance its outreach through financial service points, but as described in Text Box 2, might face some capacity constraints in doing so.

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| --- |
| **Text Box 2: *Banco Union***  **Supported by the new Constitution, the role of the public bank, *Banco Union*, is undergoing drastic change.** The new constitution mandates that a public bank conducts all financial transactions of the government, including at the local level. In general, bundling the various government accounts into one single account held at a financial entity can significantly enhance efficiency of resource management, and increase transparency. However, attention needs to be paid that the government only uses its single account for originating its payments, and allows a broad range of financial entities to compete for the delivery of the payment to the recipient.  **With a singly treasury account already in place, the government has started to shift some of its transactions from private banks to *Banco Union.***  For example, civil servants now have to become clients of *Banco Union* to receive their salary. The rationale behind this reform is not clear, as the constitutional mandate could also be fulfilled by using *Banco Union* to transfer public funds into individual beneficiary accounts held at financial institutions of the recipients’ choice. The Bono Directo, which aims to provide the population with higher interest deposit alternatives, is only available through Banco Union. Other functions, such as tax and custom payments, and the cashing-out of conditional cash transfers are also under consideration to be shifted in their entirety to *Banco Union*. If implemented, this would transfer a gigantic amount of transactions to *Banco Union* which currently are handled by the private financial system.  **Providing the payment services to public employees and beneficiaries of public programs without increasing the cost of access for those previously already “banked” customers will imply substantial investment and growth in the branch network of *Banco Union*.** This will include new branches in already well-banked locations, and also require additional human resources to cover the surge in transactions. Without direct government subsidies, this imply a reduction of available funding envelop and institutional capacity for increasing outreach to underserved localities and segments of the population, and for the development of initiatives and alliances to foster credit to micro and small enterprises – two areas in which *Banco Union* has already started to engaged. It will also draw the attention and institutional capacity of *Banco Union* away from the developmental roles the Bank could meaningfully play, and shift it towards functions that the private system is already fulfilling.  **Finally, shifting these transactions to a single bank – be it in public or private hands - will create distortions in the market, and reduce incentives for the other market participants to increase outreach.** Handling of salary payments provides an important and viable opportunity for cross-selling, and payment services such as utility payments and taxes brings clients in contact with a financial institution, and helps establish trust. Additionally, these transactions create an – albeit limited – source of income, which can help defray the costs of maintaining a branch network in a remote and small location. Handling these payments can thus be an important strategic element for increasing outreach and growth. Creating a transactional monopoly will on the other hand likely only lead to a strong dominance of and dependence on one entity, instead of supporting a more organic and sustainable growth of the entire financial sector. |

1. **The above assessment suggests that reforms need to place a stronger focus on bringing down the costs of service delivery and at setting incentives for the use and supply of modern financial products.** To complement and refocus ongoing efforts, survey work should be carried out to bridge the knowledge gap on the population’s actual access and use of financial services, and to determine existing perceptions and preferences as well as knowledge gaps that could impede uptake. Another priority would be to enhance the communication and national payment system infrastructure in the country to facilitate the use of modern banking tools. Furthermore, more flexibility and innovation will be needed to deliver financial service to less densely populated areas, for example through the use of mobile agencies, mobile banking technology and non-bank agent models. This would imply reforms of the regulatory framework to reduce the costs for security, oversight and administrative burden for those solutions and well as government support in rolling them out. Finally, financial education would be needed to familiarize the population, in particular in rural areas, with the benefits of using modern forms of payments for their transactions. The implementation of all these reforms can be considerably facilitated through the way government to person and business payment is being handled. The following paragraph discusses these possible additional reforms in more depth:

*Enhance the available data on rural areas and actual outreach:*

1. **A demand side survey to assess the use of financial services and to determine bottlenecks should be rolled out in both rural and urban areas to help the authorities determine actual gaps, define adequate policies and track their impact.** The survey should aim at determining the actual level of access to financial services by the population, at understanding the level of financial education in various segments of the population as well as determine existing preferences and perceptions that impede the use of financial services such as savings, electronic payments, credit and insurance. INE, under guidance from the financial sector authorities, would be the best-placed agency to carry out the survey. The survey is needed to prioritize and facilitate the development and implementation of different reforms and direct interventions (both geographically as well as by type of financial service), as well as to be on the longer term able to monitor the actual achievements and effectiveness of reform measures. The information thus gathered would also be of use for financial entities to design adequate and tailored products and services, and should be made publicly available. For the medium to longer term, consideration should be given to regularly include a small financial sector module in the household survey, which would allow comparing results with established baselines and fine-tuning reform measures. Considerations could also be given to including a financial sector indicator into the “*vivir bien*” indicator currently under development.
2. **It would also be useful to develop a nationwide consistent definition of what constitutes rural, and foster the availability of data on the hitherto unregulated financial entities.** In the absence of a homogenous definition of what constitutes rural, the reported data cannot be compiled and compared meaningfully, limiting policy analysis and the determination of gaps. Additionally, efforts should be furthered to verify and compile data on the closed cooperatives and the IFDs sector, including those IFDs and closed cooperatives which have so far not initiated the transition process. Adding the data on the IFDs and closed cooperatives to the general data on the financial sector would provide a more holistic picture of the coverage with financial services, and determine gaps from the supply side. Results from the mission suggest that this will be a difficult and time-consuming task, and thus might imply the provision of – at least temporary – dedicated additional funding for ASFI.

*Supporting the availability of ICT and fostering a more integrated national payment system:*

1. **The government might want to link the rollout of new ICT coverage with a gap assessment for financial services.** Targeting of the ICT rollout could at least for ENTEL be harmonized with perceived deficiencies in access to finance in rural areas, taking into consideration the work that ASFI has already undertaken to map the availability of financial services by localities and targeting explicitly remote rural areas, to which conditional cash transfers are being channeled regularly, but where geographic access is difficult either due to distance, a difficult terrain or insufficient road infrastructure. Furthermore, prior to the rollout ENTEL should consult with the financial sector to determine technical requirements, in particular whether the rollout of 2G technologies is sufficient, or should be upgraded to a more advanced technology. Those “priority” localities could be serviced with a combination of mobile banking platforms (POS) to recharge the smart cards on-line and in real-time (occasionally), and using the cards for regular or standard payment transactions off-line. This can only work with a holistic effort between the various ministries, technological platform providers and the financial system involved.
2. **In the area of the national payment system, efforts to integrate the various available systems as well as setting incentives for the use of modern electronic payment mechanisms could be considered.** The recent emergence of individual payment system initiatives in the private sector is positive and should be encouraged. However, the focus on developing own systems and the likely ensuing lack of interoperability will increase inefficiencies and duplication in coverage, as ATMs and POS systems will be set up in areas where others are already operational. The financial sector authorities should monitor and oversee the various emerging systems and promote inter-linkage of the systems through the development of a common standard and the provision of a joint platform. Reforms along those lines have in part already been initiated by the Central Bank. Furthermore, considerations could be given on how the costs of the needed infrastructure investments could be lowered and adequately covered. Ideally, those measures should be considered in combination with financial education programs as discussed below. Options could include for example:

* **Easing of the regulation on commission income, through for example the creation of basic accounts with a limited number of free transactions.** This would allow the financial entities to charge commissions for transactions from the other types of accounts, thus create some income on the infrastructure investment while at the same time fulfilling the financial inclusion goal of providing an affordable deposit account to the population with lower incomes and limited transactional needs. Reforms along this line should be accompanied with efforts to enhance price transparency for transactions.
* **Regulations and direct support for fostering the use of electronic transfers.** This could include issuing regulations to promote the use of payment instruments in certain commercial transactions[[86]](#footnote-86), as well as reforms on how the government does its government to person or business transactions. Instead of ongoing efforts to channel public salaries exclusively through *Banco Union*[[87]](#footnote-87), the government could for example consider mandating the use of direct debits for the payment of salaries of formal private enterprises and government entities, while leaving the employee with the choice of picking the regulated financial institution for the deposit account. This could imply higher costs for monitoring and enforcing in the case of private entities, as the government has less direct control over them, but could easily be implemented for public entities. This could still have a significant demonstration and financial education effect.
* **Setting of tax incentives to allow deductions for the investments on the supply side or lower taxation rates for the use of electronic payments on the demand side to stimulate usage of selected payment instruments.** Investments into payment system infrastructure or developing agent models could for example be deducted fully from taxable income of financial entities, or – as has been done in Argentina - the use of electronic transfers could be supported through a re-crediting of a the value added tax into the account of the card user.
* **Direct provision of subsidies to support implementation of infrastructure.** In order to facilitate the provision of financial services in remote rural areas, the government might want to consider options to subsidize the technical equipment needed to deliver financial services, such as for example assuming the costs for satellite connectivity, covering a share of the investment costs in POS devices, and supporting fingerprinting technology where there is a confirmed lack of identification documents.

*Reforms to the regulatory framework:*

1. **The regulatory framework for branches and other service points already defines and regulates a number of innovative solutions, but should be adapted to incorporate recent cost-saving international experiences.** Experience in other countries suggests that not all localities and types of service points require the same amount of security standards**.** While installing substantial amounts of security equipment might be justified in some locations, the investments might be unnecessary in other locations and should thus be left to the discretion of financial entities[[88]](#footnote-88). Furthermore, it is not clear why mobile branches should be so tightly regulated, when they are in reality just another form of an “*oficina ferial*”. Finally, the ASFI might want to revamp the regulatory framework to only set core minimum requirements such as necessary oversight roles of headquarter or a main branch and the needed financial management information systems, but introduce more discretion in security requirements, services offered and institutional requirements.

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| Text Box 3: Reform measures in India to increase financial inclusion  Reform measures by the Reserve Bank of India to enhance access to financial services by low-income households, in particular in rural areas:   * 2005: Introduction of a ‘no-frills’ account with low or zero minimum balances and minimum charges. * 2006: Issuance of regulation to allow the use of non-bank agents (non-governmental organizations, microfinance institutions, retirees - of banks, government and military - as well as civil society organizations) for the provision of financial services. The restriction on who could act as non-bank agent was widened in 2009, and the maximum allowed distance between a non-bank agent and a linked bank branch increased from 15 to 30 km. * 2008: RBI permits banks to offer mobile banking transaction facility to their customers subject to a daily cap of Rs. 5,000/- per customer for funds transfer and Rs. 10,000/- per customer for transactions involving purchase of goods/services. * 2009: Elimination of need for procuring a license for setting up ATMs, and for opening a bank branch in towns and villages with less than 50,000 inhabitants. However, banks are required to set up at least one third of new branches within under-banked districts of under-banked states. * Banks are also being allowed to charge customers “reasonable fees” (determined by each bank) for using services through non-bank agents, thus enhancing the bank’s and agent’s business case for this delivery channel. * Ongoing: The RBI is in consultation with state governments to encourage adoption of electronic benefit transfers (EBTs) by banks. It has also launched a financial inclusion drive targeting one district in each state for 100 percent financial inclusion.   These efforts have yielded positive results. A research study conducted in Karnataka concluded that financial inclusion efforts of opening no frills accounts resulted in nearly 60 percent of the adult population opening a bank account. This is high when compared with other developing countries such as South Africa (32 percent), Tanzania (6) or Colombia (39), but low when compared with Denmark (99), the UK (88) or the US (91). |

1. **Additionally, some of the regulations to enhance consumer protection impose significant additional costs for opening and maintaining service points and should be revised to facilitate outreach to underserved segments of the population or new geographic areas.** This includes regulations to eliminate commissions as discussed under payment system reforms, costs incurred for changing larger bills into smaller denominations free of charge, the security measures mandated for ATMs to protect the client from direct assaults, the installation of a Service Representative for client complaints in all branches as well as the tracking of service times for all locations. In particular the mandate to serving every client within 30 minutes in each branch can increase costs in more remote locations which can witness significant fluctuations in client business, yet are involved in conditional cash transfers that bring for a brief period of time large number of clients to the service point.
2. **Finally, to foster and facilitate the roll-out of branchless banking solutions, the legal framework should be assessed to clarify whether the recommended laws and regulations are in place.** This would include a review of regulations pertaining to e-commerce, the issuance of e-money; know your customer regulations for opening of virtual accounts or by third parties, and other regulations regarding the use of agents. It should also be clarified whether money network operators can offer those services on a stand-alone basis, or to what extent they need to involve regulated financial institutions, and which communication, security standards and consumer protection regulations need to be determined in agent models[[89]](#footnote-89).

*Foster new technologies to reach out to underserved localities:*

1. **The government can play an important role in fostering the use non-bank agents**. This would include:

* **Fostering the development of agent relationships within the financial sector.** IFDs for example cannot receive deposits and have no access to the national payment system, but could as agents of banks or finance companies offer those services to their clients. This could be used to provide incentives for IFDs and closed cooperatives during the transition process, and allow for some twinning and capacity building from larger institutions to smaller ones. Furthermore, it would allow deepening already existing relationships between financial entities and individuals, and benefiting from the already solid understanding of financial services by staff of so far unregulated entities. Several entities already expressed interest in such solutions, but so far no direct forms of cooperation have emerged.
* **Channeling government to person payments through non-bank agents.** The government has a significant number of transactions that could make the development and rollout of innovative payment solutions interesting and feasible for the private sector. The government should thus aim to determine the number of regular transactions it conducts in individual municipalities / localities; assess the use of alternative payment options available within the financial system, and contract out the provision of payment services where feasible through accounts or payment cards. Similar efforts were successfully undertaken for the delivery of conditional cash transfers in countries like Brazil, Colombia and Mexico, and are currently underway in India and Honduras.
* ***Banco Union* could become a pioneer in establishing those agency relationships,** for example through contracting agents in target localities in the initial two years of operation on an exclusivity basis, and then open the agent relationships up to other financial service providers. To facilitate this, the government should reconsider whether it is necessary to transfer the full execution of all financial transactions originating in the government and especially of the management of salaries to *Banco Union*, or limit this mandate to the direct processing of the government funds, with the entire financial system being where possible involved in the actual delivery of payments to the private business or individual. This would free *Banco Union* to focus its scarce resources on reaching out to geographic areas that are not yet covered by a financial institution, and to provide funding to underdeveloped sectors which are determined as priority sectors.

1. The rollout should be supported and facilitated by the government through media campaigns, workshops and seminar with stakeholders, and tax incentives or other direct monetary support for the establishment of agent networks and the building of trust in the population.

*Provide targeted financial education based on findings from the survey:*

1. **In addition to already developed workshops and promotional material, broader financial education campaigns could be launched to change perceptions and attitudes towards the financial system as determined through survey work.** ASFI and the Central Bank have already established a work-program and material to increase the level of financial education in the population. ASFI regularly conducts workshops and seminars with entrepreneurs and students in selected locations, with so far strong interest and positive feedback from the participants. The Central Bank focuses on a broad information campaign to help create knowledge on the composition of the financial system, its functioning, and measures to enhance its security. However, in the absence of surveys to determine the actual gaps in financial education and cultural factors, both work programs have naturally stayed broad. Moving ahead, a more targeted approach could be considered. Radio talk shows, TV shows and other targeted media campaigns can have a good impact on increasing the awareness of the population of different payment alternatives, and familiarizing the population with how they work. In combination with carefully designed promotion campaigns, built on experiences gained while piloting the delivery of conditional cash transfers (CCTs) and government salaries through modern technologies, this could be a very effective way of promoting the use of the services and reaching scale, while at the same time lowering the initial start-up costs and riskiness for financial institutions to develop and roll out those techniques.

# Fostering credit to MSMEs

*Credit to the private sector as a share of GDP decreased over the last few years in Bolivia, but its composition shifted towards a stronger inclusion of smaller borrowers. Enterprises have in general access to working capital, partially funded by sources outside of the financial system such as remittances and grants, but are restraint with regard to investment financing and larger working capital loans. There are a number of demand and supply side bottlenecks that contribute to this:*

* *On the demand side, the economic structure of the country, in particular the large share of micro and small enterprises, a poor overall investment climate, as well as the lack of integration into value chains impede profitability in the enterprise sector and limit growth “opportunities”. Thus, in the first place a larger and more coordinated effort to foster economic growth through elimination of barriers to the investment climate and integration of the MSME sector will be required.*
* *With regard to supply of credit from the financial sector, neither the available resource envelope nor the level of interest rates were determined to be significant constraints for the expansion of lending, including to the productive sector. The above mentioned demand side barriers much rather point to higher risks involved in lending to the productive sector, with non-performing loans traditionally being higher in this segments, as well as higher costs involved in gathering information on (potential) clients due to the prevailing informality in doing business. The assessment highlights gaps in available risk mitigating tools (i.e. available collateral) and products (i.e. factoring and leasing) and information infrastructure. Reforms to the collateral regime and credit bureau infrastructure should thus be priorities in order to facilitate a borrower’s eligibility for loans, while legal reforms and government support should aim at fostering the use of risk-mitigating products such as leasing, factoring and partial credit guarantees. Furthermore, fostering links between financial institutions and value chains could be useful to overcome information barriers, and link recipients of grant funding to the financial sector in order to help them graduate from direct government support.*

## Access to credit – Actual situation and evolution over time

### Demand for credit

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| **Chart 15: Sources of funding of enterprises** |
|  |
| *Source: World Bank – Enterprise Surveys (latest available).* |

1. **As in the case of access to financial services by the population, hardly any survey results are available to measure the enterprise sector’s access and use of financing from the financial sector.** The statistics institute INE conducted a number of surveys on the agricultural sector, manufacturing industry as well as the export sector. Although these surveys include one or two questions on the main sources of funding, the results on those questions are not publicly available and in the absence of a broader set of questions cannot provide any indication on drivers behind the actual recorded level of access[[90]](#footnote-90). The Enterprise Survey of the World Bank (2006, see Chart 15) shows that formal enterprises rely to over 60 percent on own resources to fund investments, which is higher than regional and worldwide averages. This could reflect personal preferences to only invest when sufficient own resources or grant funds are available, but could also point to restrictions in available external funding for investment purposes – an aspect that was highlighted in a number of interviews. With regard to external sources of funding, credit from financial entities plays an important role for investment financing, accounting for over 22 percent of funding, while trade credit and other sources of funding such as supplier credit are negligible. The latter is likely a result of the discussed lack of strategic alliances within the enterprise sector, which naturally limits the available financing from suppliers or wholesalers. Funding via capital markets does not play a role.
2. **Demand for financial services from larger enterprises decreased due to lower investment activities originating in the private sector.** Several aspects contributed to this. The government’s policies to foster public investment and ownership in a number of sectors, such as hydrocarbons, telecommunication, air transportation and electricity, have reduced the size of the country’s private sector. Together with efforts to set up public entities to foster the development of small-scale farmers and productive businesses[[91]](#footnote-91), this has created some insecurity over the intended long-term role of the state, the chosen strategic sectors, as well as over potential distortions that could arise out of it. Measures like this negatively impact the investment climate for the private sector, in particular of large enterprises that contribute a vast share to overall GDP. Furthermore a number of market developments and competitive pressures reduced overall demand for some products, and lowered enterprises’ need for external funds[[92]](#footnote-92). Private fixed capital formation as a share of GDP dropped from 12 percent in 2000 to currently 6.8 percent (see Chart 16), with for example private sector investment in energy and telecommunication witnessing a reduction by 50 to 70 percent between 2000 and 2009[[93]](#footnote-93). The level of foreign direct investment also fell from over 8 percent in 2005 to 2.5 percent in 2009, indirectly impacting the growth potential of local suppliers for working and capital financing. This drop in investment in the private sector was compensated by a large increase in investment by the government, which however was funded from sources outside the private financial sector.

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| Chart 16: Gross fixed capital formation of the private sector (as % of GDP). |
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| *Source: World Bank.* |

1. **Small and medium sized enterprises usually demand and have access to working capital, but feel constraint with regard to investment financing and larger working capital loans.** Information from the World Bank’s Enterprise Surveys (2006), the Bank’s study on informality (2007) as well as interviews carried out in the frame of this study generally confirms that access to larger credit amounts is considered as an obstacle for enterprises in Bolivia, while smaller sized loans are not perceived as a constraint. All of the interviewed companies reported to have some credit from the formal financial sector, and visited producer associations confirmed the availability of small loans from a variety of financial institutions, pawn shops and to more limited extent from suppliers. Additionally, many micro-entrepreneurs receive remittance income or have access to available government or donor grants, leading to a lesser dependence on external funding sources. Constraints reportedly mostly exist with regard to credits over USD 10,000, which require collateral in the form of real estate. Specific credit design features, such as the lack of grace periods to allow investments to generate income also constrain the usefulness of such loans. Furthermore, in the absence of strategic alliances with buyers and markets, enterprises report of difficulties in benefiting from growth opportunities through larger one-time contracts offered by existing or new clients. In line with prudent risk management standards, financial entities are reportedly reluctant to fund the necessary investment and working capital to scale up production without a stable larger contract base in place to make the investment viable on the longer term, and require high levels of collateral. The latter – if available - is in many instances already used to finance the needed working capital, making the borrower ineligible for additional lending.
2. However, most interviewed companies and associations agreed that access to finance is not the most pressing problem and that increasing access to financial services in the absence of targeted technical assistance to help enterprises develop the necessary entrepreneurial skills or to foster integration along the value chain could potentially lead to repayment problems and ensuing over-indebtedness.

### Supply of credit

1. **The client base shifted towards clients with credits between USD 1,000 and 10,000**.

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| **Chart 17: Evolution of credit by loan size** |
|  |
| *Source: World Bank’s own calculations, based on data from ASFI and the Central Bank.* |

This client segment now accounts for close to 60 percent of the total borrower base, up from 42 percent in 2006. Some of the growth into this market segment is the result of the Bolivian microfinance market being a mature market, with the strong competition between the financial institutions supporting the graduation of micro-borrowers into larger loan sizes[[94]](#footnote-94). This needs to be watched as it can lead to over-indebtedness if the increased loan sizes are not appropriate to the business’s payment capacity. The strong increase in loans to the commercial and services sectors also supported the increase in number of small borrowers, as these sectors usually mostly need working capital and do not demand large credits and longer maturities. Finally, the regulatory framework allows for microcredit up to Bs 84,000 (~ USD 12,000) to be granted with personal or group guarantees, and for loans under BS 54,000 to be granted with unregistered chattel mortgage. These regulations provide strong incentives for entities to stay within this range - in particular if a financial entity reaches the limit of unguaranteed loans to capital. While the facilitation of guarantee requirements is positive, it nevertheless provides disincentives for investment loans in the range of USD 10,000 to 30,000 - a fact that was repeatedly mentioned during interviews with the private sector[[95]](#footnote-95).

|  |  |
| --- | --- |
| Chart 18: Credit growth by type of entity and by department | |
| *Credit growth was strongest for microfinance institutions, which correspondingly increased their market share in credit.* | |
|  |  |
| *Smaller departments profited disproportionally from credit growth, with microfinance institutions increasing their already strong presence in the small departments such as Pando, Beni and Potosi further.* | |
|  |  |
| *Source: World Bank’s own calculations, based on data from ASFI and the Central Bank.* | |

1. **Departments like *Beni*, *Potosi*, *Tarija* and *Pando* saw their loan portfolio and number of borrowers increase, but overall continue to account for only a fraction of borrowers and loans by volume.** MFI banks, finance companies and lately the public bank (coming from a low base) more than doubled their client base, adding 80 percent of the 350,000 additional borrowers in the 6 less populated departments since 2005. They also had the strongest growth in credit, as can be seen in Chart 18. This cut into the market share of cooperatives which however continue to play an important role in some of the smaller departments, with for example a market share of 32 and 19 percent of borrowers in *Potosi* and *Tarija*. Credit growth was more pronounced in the 6 smaller departments, but the departments of *La Paz*, *Santa Cruz* and *Cochabamba* continue to account for 79 percent of borrowers and 86 percent of loans by volume (down from 80 and 88 percent in 2005).
2. **Growth was unevenly distributed amongst the sectors, with a lower share of credit now going to the traditional productive sectors.** Loans to commerce, the services sector and construction more than doubled between 2005 and December 2009, and dominate the loan portfolio of the formal financial system with a share of 24, 34 and 14 percent respectively. On the other hand, credit to the traditional productive sectors (agriculture, forestry, manufacturing industry and extractive industries) only increased by 23 percent over the same period of time, and now only account for 20 percent of lending compared to 29 percent in 2005. This widened the already existing gap between credit to the productive sector and its share in GDP further (see Chart 19) and led the government to issue a number of circulars and regulations to stimulate credit to the productive sector, and to provide dedicated funding sources for productive credit through its second tier bank and through grant programs.
3. **With regard to the type of credit, microcredit and to some extent also consumer loans gained market share**. The increase in microcredit is almost exclusively due to the growth of MFI banks and finance companies, while consumer credit increased mostly in the cooperative sector, the SLAs and the public bank (see Chart 19)[[96]](#footnote-96). Microcredit and consumer loans now account for 24 and 11 percent of loans respectively (up from 16 and 8 percent in 2005), while commercial loans declined by 10 percent to 47 percent, and mortgages stagnated at around 18 percent.

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| --- | --- |
| Chart 19: Credit by type of loan and sector. | |
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| *Source: World Bank’s own calculations, based on data from ASFI and the Central Bank.* | |

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| --- | --- | --- | --- | --- |
| Table 10: Evolution of non-performing loans (NPLs) by sector | | | | |
|  | **Non-performing loans (%)** | | | |
| **2005** | **2007** | **2009** | **Sep. 2010** |
| ***Production*** | ***14.7*** | ***7.8*** | ***5.0*** | ***3.3*** |
| Agriculture and livestock | 20.5 | 13.8 | 9.3 | 3.8 |
| Hunting, forestry and fishing | 16.9 | 3.2 | 2.5 |  |
| Crude oil and natural gas extraction | 2.7 | 1.3 | 1.5 | 0.8 |
| Mining | 3.0 | 1.6 | 2.1 | 1.2 |
| Manufacturing | 13.0 | 7.0 | 4.5 | 3.1 |
| Production and distribution of power, gas and water | 0.1 | 0.0 | 0.0 | 0.0 |
| Construction | 17.5 | 7.8 | 5.0 | 3.9 |
| ***Commerce and Services*** | ***8.6*** | ***4.1*** | ***2.6*** | ***2.1*** |
| Wholesale and retail | 11.1 | 4.5 | 2.5 | 2.1 |
| Hotels and restaurants | 10.1 | 6.7 | 5.9 |  |
| Transports, storage and communications | 6.5 | 3.1 | 2.3 |  |
| Financial Services | 13.5 | 11.2 | 5.2 | 3.3 |
| Real estate, rental and other corporate services | 7.5 | 3.6 | 2.3 | 2.1 |
| Public administration, defense and mandatory social security | 0.2 | 0.1 | 0.4 |  |
| Education | 3.5 | 4.6 | 2.4 |  |
| Social, community and consumer services | 7.2 | 3.1 | 3.4 | 2.4 |
| Domestic services by private households | 1.6 | 6.6 | 0.0 |  |
| Services of organizations and external organs | 0.1 | 0.3 | 7.3 |  |
| Unusual activities | 8.5 | 1.2 | 1.3 |  |
| ***TOTAL PORTFOLIO*** | ***11.3*** | ***5.6*** | ***3.5*** | ***2.5*** |
| *Source: ASFI.* | | | | |

1. **Aside of the factors constraining the growth of the productive sectors, the historically low quality of the portfolios of loans granted for productive businesses may constitute an important factor for the slow growth of such portfolios.** As Table 10 shows, loans granted for agriculture, manufacturing and construction maintained significantly higher levels of NPLs from 2005 to 2009, thus generating higher provisioning costs and a higher risk perception to lending institutions than other portfolios.

## Barriers to credit growth

### Core characteristics of the enterprise sector in Bolivia and factors affecting its growth potential

1. **The following paragraphs assess to what extent important preconditions for growth are met in Bolivia’s enterprise sector or whether barriers to access to finance exist from the demand side.** Experience worldwide suggests that the overall investment and business climate in a country impacts the ease and cost of doing business, with deficiencies leading to micro and small firms staying in the informal sector and or having lower growth prospects. The existence of strategic alliances also plays a role, with a stronger integration allowing for economies of scale in production, marketing and quality control, and higher profitability and more “opportunities” of growth. Well-organized value chains can also facilitate access to financing, through for example financing along the value chain and tailoring of factoring and leasing products to requirements of the value chain.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Table 11: Formal enterprises by type** | | | | |
| Share | By number | Micro businesses | Limited liability | Rest |
| All registered enterprises | 44,517 | 70% | 27% | 3% |
| Productive sector | 5570 | 59% | 36% | 5% |
| - Agriculture/livestock | 633 | 38% | 52% | 11% |
| - Extractive | 683 | 36% | 39% | 24% |
| - Manufacturing | 4,489 | 62% | 32% | 6% |
| *Source: Fundempresa* |  |  |  |  |

1. **There are a number of factors that affect the investment climate in Bolivia and impact the profitability and growth of the enterprise sector in Bolivia.** In rural areas, only 56 percent of the population has access to electricity, compared to 98 percent in urban areas[[97]](#footnote-97). Furthermore, the small agricultural farms frequently also find it difficult to bring their produce to the local market, as the road infrastructure is not sufficient to cover the many dispersed locations. Furthermore, the low ICT coverage limits the capacity of enterprises to communicate with buyers that are further away. Finally, there are a number of bureaucratic hurdles for doing business, which make formalization costly and time consuming. The international comparison for Doing Business Indicators for example reveals vast deficiencies in the administrative processes for opening a business and paying taxes, and also significant shortcomings in registering a property, enforcing contracts, and trading across borders. These administrative barriers, as mentioned in the Doing Business report, in combination with perceived corruption and rigid labor laws for formal enterprises, contribute to the high level of informality in the country, and thus to the large share of dispersed and unprofitable microenterprises in Bolivia.
2. **The mentioned constraints in the investment climate contribute to the fact that only a limited number of formal enterprises operate in Bolivia, the majority of which are small[[98]](#footnote-98).** As of January 2011, 44,517 formal enterprises were registered in the commercial registry *Fundempresa*, of which 70 percent were micro businesses with in many instances less than 5 employees, 27 percent were limited liability companies, and another 3 percent corporations (see Table 11). Enterprises in the productive sector[[99]](#footnote-99) only account for 13 percent of registered enterprises. In the agricultural sector, the few registered enterprises are mostly associations and cooperatives that represent a number of small-scale farmers, while the extractive industry sector is comprised of larger companies (likely due to higher initial investment and operation costs). In addition to the companies listed in *Fundempresa*, an undisclosed number of companies have a national tax identification number and / or a municipal license, but no consistent database exists that compiles the tax and municipal data. There is some suggestion that the incentive to register is only high for enterprises that cater to foreign clients and thus need to register in order to fulfill custom requirements, while the other enterprises frequently do not see the benefit that registering, paying taxes and adhering to the rather stringent labor law could bring compared to the costs involved (see World Bank (2007) for more in-depth information).
3. **In addition to the formal enterprise sector, Bolivia has a vast informal sector and a one of the highest ratios of micro-entrepreneurs in the region**. Around the turn of the century, it was estimated that the microenterprise sector accounted for significantly more than 90 percent of all enterprises in Bolivia, compared to around 78 for Costa Rica and Guatemala, 80 percent for Chile and Panama, and 95 percent for Mexico, Peru and El Salvador[[100]](#footnote-100). While reforms in the last few years have helped increase the number of formal small and medium sized enterprises in Bolivia[[101]](#footnote-101), there is no consistent data available to determine the actual share and size of microenterprises in the economy[[102]](#footnote-102). Informality is high. Estimates put the informal economy at around 70 percent of Bolivia’s GDP[[103]](#footnote-103) - the highest in the region - and informal employment at 70-80 percent of the economically active population[[104]](#footnote-104). There are broad differences by sector, with for example the agricultural survey (INE 2008) showing that around 96 percent of the enterprises in the agricultural sector are small farms run by individuals or families[[105]](#footnote-105).
4. **A World Bank survey in 2007 shed some more light on the level of informality in selected commercial and productive sectors.** As can be seen in Table 12, over half of the sample group had a municipal license, but only 5 percent of the 629 enterprises interviewed during 2007 were registered at *Fundempresa*. The share of available licenses fluctuates widely between the 6 sectors analyzed, indicating some differences in perception of and actual benefits derived from registering. The latest available data and interviews with stakeholders confirm that the enterprise sector continues to be dispersed and of limited scale.

Table 12: Core results of a survey on levels of information in enterprises in six sectors of the economy (in percent)

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Total enterprises** | **By sector** | | | | | |
| **Clothing** | **Transport** | **Packaged goods** | **Food Service** | **Forestry** | **Woolen** |
| Registered in *Fundempresa* | 5 | 6 | 11 | 4 | 3 | 4 | 2 |
| Have a tax identification number (NIT) | 27 | 26 | 29 | 36 | 38 | 28 | 8 |
| Have a municipal license | 53 | 46 | 63 | 75 | 61 | 61 | 12 |
| Keep formal accounting | 10 | 9 | 12 | 9 | 12 | 13 | 5 |
| Keep some level of accounting | 66 | 73 | 68 | 67 | 73 | 68 | 48 |
| Always ask for purchase receipts | 28 | 27 | 54 | 31 | 20 | 29 | 8 |
| Always provide sales receipts | 5 | 4 | 7 | 5 | 4 | 7 | 3 |
| 50% of times provide sales receipts | 13 | 11 | 13 | 16 | 14 | 21 | 3 |
| Formal location is outside housing | 32 | 39 | 47 | 31 | 32 | 19 | 25 |
| Part of a labor union or professional association | 27 | 14 | 63 | 8 | 17 | 25 | 33 |
| *Enterprises with paid employees* |  |  |  |  |  |  |  |
| Employees are affiliated to the National Health system (CNS) | 10 | 7 | 10 | 16 | 8 | 13 | 4 |
| Employees are under the Bolivian Pension Fund (AFP) | 6 | 7 | 4 | 5 | 8 | 7 | 4 |
| Employees are registered in the Labor Ministry (MT) | 8 | 10 | 11 | 11 | 8 | 6 | 4 |
|  | | | | | | | |
| **Size of the sample** | **629** | **101** | **112** | **103** | **107** | **100** | **106** |
| **Size of the sample with paid employees** | **379** | **70** | **72** | **38** | **72** | **82** | **45** |
| *Source: World Bank (2007).* | | | | | | | |

1. **The productive sector in many instances lacks integration within the different value chains, contributing to low levels of standardization and quality of products.** While some progress towards integration was made in selected value chains such as coffee, cocoa, wood and textile, the overall level of horizontal and vertical integration within the value chains continues to be low. Many companies, including small and medium sized enterprises, do not have established and reliable contractual relationships with clients and/or suppliers but cater to a number of short-term contracts, which fluctuate both in size and value and are not predictable over time. As the domestic market continues to be small, enterprises frequently have to rely on external demand to grow and reach scale, but in many instances cannot deliver the needed quantities of higher quality products required to reach the scale needed for international markets. The lack of organization contributes to insufficient standardization of products, which limits economies in scale in production for various buyers. Small producers frequently also have limited access to larger markets. There are a number of support structures available in the country to facilitate marketing and strategic alliances (see Text Box 4), provide guidance on modern production technologies and establish relationships within clusters (i.e. to suppliers of modern machinery and equipment, financial system etc), but the support is in general dispersed over a number of public and private sector stakeholders as well as and non-profit associations and is not sufficiently coordinated and targeted.

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| Text Box 4: Access to financial services within value chains  Both supply and demand side information indicate that enterprises that are part of a well defined and organized value chain benefit from enhanced access to financial services. An example is the coffee value chain. A study conducted by Chemonics International in 1999/2000 highlighted a number of weaknesses in the Bolivian Value Chain for Coffee:   * Small farm size, with deficient crop management and post-harvest processing (in part due to missing on-site processing facilities), * Lack of entrepreneurship, including in the area of marketing, processing and quality management, * Outdated machinery and production technology, in part due to lack of knowledge on more innovative approaches, * Fragmentation of organizational structure, with the lack of collaboration leading to a lack of developed standards, limited pooling of resources and also deficiencies in marketing / negotiation to gain market power.   Based on this assessment, the consultants concluded that enhanced access to financial services would be valuable to update the machinery and processing facilities of the coffee producers, but that the limited business management skills of small producers would not be sufficient to “manage the credit well”. Since then, a number of support structures have been set up to support the development of the coffee value chain, which helped improve the overall access to financial services by the coffee producers:   * The National Federation of Coffee Exporting Producers, created in 1991, sells coffee in the organic and fair trade markets on behalf of its members, supports the development of cooperative structures on the local level, and provides targeted technical assistance and marketing services to small-scale producers of organic coffee. It has supported the certification of its members, and with its 20 technical staff undertakes quality control. To support access to credit for its members, it founded Fincafe, which in 2002 was listed as an NGO. Fincafe receives funding from its member associations, and also from donors and other financial institutions. It works through local credit officers in the affiliated associations and cooperatives, who establish a personal knowledge of the client. Their loan portfolio is in general not collateralized, and is based on the estimated volume of production. * Direct support to the development of small scale coffee producers was also provided as part of a Market Access and Poverty Alleviation project by USAID in collaboration with the authorities (2000-2005). It helped establish organic coffee production of high quality, supported direct linkages between producers and traders, and supported the development of processing facilities. An impact evaluation done for the project confirms that the project helped producers significantly increase their income through coffee harvesting and due to the direct linkages with traders of high quality coffee to eliminate the payment delay for the harvest.   According to interviews with various financial and non-financial NGOs, the coffee value chain today is one of the more advanced and organized value chains in Bolivia. This has created interest from a variety of financial entities in providing financing to this market, and ONGs, microfinance institutions as well as commercial banks reported to now extent funding to the sector. Yet, visited associations and microfinance institutions confirmed that technical assistance needs continue to be elevated, and credit should be accompanied by technical assistance to raise quality and enhance production techniques in the respective economic sectors. |

1. **The factors mentioned above constrain the growth potential of MSMEs in the country, which in turn has negative effects on the demand for loans.** Two studies[[106]](#footnote-106) and interviews carried out in the context of this work confirmed that producers usually have a high technical skill level with regard to understanding their products, but in many instances lack a vision, as well as business planning and marketing skills to be successful. Furthermore, being small, they frequently do not have sufficient resources and knowledge to search for information on the most efficient production techniques, or to understand how to use innovative solutions to raise their outputs and production and to improve the quality of their product as required for international markets. Combined with lower levels of access to financial services and low market power in the absence of well organized value chains, this resulted in lower levels of investments in modern production technologies and in turn a manifestation of lower levels of productivity.

### Eligibility and affordability barriers

#### Barriers to eligibility of borrowers

Important regulatory and institutional deficiencies exist in financial infrastructure of the credit market, which reduces the eligibility of enterprises and the population with lower income levels from funding through the formal financial sector:

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| Chart 20: Firms required to pledge collateral in a percentage of firms that applied for credit |
|  |
| *Source: World Bank – Enterprise Survey.* |

1. *Collateral requirements:*
2. **Financial systems in both developed and developing countries rely to a larger extent on secured transactions for guaranteeing their lending portfolios.** As can be seen in Chart 20, around 70-80 percent of the loan portfolios worldwide is usually secured by some type of collateral, with movable collateral for example accounted for 60 percent of all collateral in the United States in 2004[[107]](#footnote-107). Micro, small and medium sized enterprises frequently lack immovable property to give as collateral[[108]](#footnote-108), but can provide accounts receivable, inventories, equipment or intellectual property rights to secure the transaction. If restrictions exist as to what constitutes collateral, this limits in particular micro and small companies’ access to financing, making them (i) ineligible for funding overall, or (ii) unable to afford loans due to higher interest rates, lower loan sizes and shorter loan maturities[[109]](#footnote-109). Restrictions on permissible collateral thus can reduce investment, in particular of MSMEs, and as a consequence lower economic growth in a country.
3. **In Bolivia, guarantee requirements for loans are high, and depend mostly on the availability of real estate.** The legal framework in Bolivia in general only allows real estate and vehicles as collateral, but ASFI has recently further increased the types of acceptable collateral for regulatory purposes up to a certain loan size[[110]](#footnote-110). Financial entities rely to a large extent on available collateral for their loans, with only a fraction of the loan portfolio being unsecured (see Table 13). Half of the loan portfolio is guaranteed with real estate. The collateral value is usually a multiple of the credit, with some interviews suggesting a required collateral to loan ratio of up to 300 percent, and Doing Business showing an average value of collateral needed of 188 percent of the loan value, compared to 134 and 144 percent for the region and worldwide respectively. Microfinance banks, cooperatives and finance companies also use personal guarantees, but even in those institutions mortgages are the predominant form of collateral.

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| Table 13: Share of collateral in loan portfolio (November 2010) | | | | | |
|  | Banks | Coopera-tives | Finance Compa-nies | SLAs | TOTAL |
| Mortgage | 47.2% | 50.5% | 38.0% | 92.7% | 48.5% |
| Securities | 0.4% | 0.0% | 0.0% | 0.0% | 0.3% |
| Pledge | 24.3% | 1.0% | 18.1% | 0.0% | 21.5% |
| Warrant | 0.7% | 0.0% | 0.0% | 0.0% | 0.6% |
| Deposits in the financial institution | 2.6% | 1.8% | 2.6% | 0.2% | 2.4% |
| Guarantees from other financial institution | 4.5% | 0.1% | 0.2% | 0.1% | 3.7% |
| Other guarantees | 3.8% | 0.1% | 1.4% | 0.7% | 3.2% |
| Personal guarantees | 10.5% | 42.9% | 35.0% | 3.2% | 14.2% |
| **Total portfolio with guarantees** | 94.0% | 96.3% | 95.3% | 97.0% | 94.4% |
| **Total portfolio without guarantees** | 6.0% | 3.7% | 4.7% | 3.0% | 5.6% |
| *Source: ASFI.* | | | | | |

1. **There are very strong restrictions for firms to pledge real estate properties as collateral, especially in rural areas.** Urban properties oftentimes cannot be pledged as collateral as the information on the titles is not up to date. In rural areas, the use of real estate as collateral is constrained for small properties due to agricultural reform legislation since 1952 which restricts owners of small lands with regard to the sale and mortgaging of their land, and for larger properties through the new Constitution and recent agrarian reform legislation, which subordinate larger properties to the obligation of owners to use properties in line with their social and economic role[[111]](#footnote-111). The compliance with this requirement is verified every two years by the government, but it is not clear on which basis the adherence to this role is measured. At the current stage, these restrictions on the property rights on rural land hinder financial institutions from granting larger loans to farms and to rural businesses. Some of the entities interviewed in the course of this work mentioned, that these limitations on the growth of the credit portfolio prevents them from opening branches in rural areas, because they would not be able to break even.
2. *Financial statements:*
3. **As in many other countries, financial statements of MSMEs either are not available or are not reliable.** It is a common problem in developing countries that micro and small enterprises lack reliable financial statements that can reveal their true financial position and income situation. A similar situation exists in Bolivia. The Bank’s Enterprise Surveys (2006) show that over 70 percent of the interviewed formal enterprises had audited financial statements available, which is high for both the region (around 50 percent) and worldwide (46 percent). Yet, at the same time, over 50 percent of the interviewed companies agreed that the financial accounts likely understate the true income for tax purposes, thus do not reliably reflect the actual situation and income generation capacity of the company.
4. **On the other hand, a large number of micro and small enterprises do not even have basic accounting practices in place.** Many MSMEs do not have to report their financial situation for tax purposes and are thus in many instances not familiar with tracking their income and expenses at all[[112]](#footnote-112). As can be seen in Table 12 on page 65, only a small fraction of the enterprises actually keep book regularly, while the majority uses rudimentary and incomplete accounting techniques to track or partially monitor their expenses and income. Furthermore, many enterprises do not provide the clients with a receipt, and as a result will likely not be able to provide a reliable overview over their sales during a given time period. Finally, as indicated during discussions with producer associations, visited enterprises and financial institutions, many enterprises rely on verbal contracts, which can neither be enforced nor used as proof of pending income. The lack of financial information reflects in part the level of informality of the enterprises, but also deficient entrepreneurial skills of the owners. Without reliable written information, an assessment of the financial situation and repayment capacity has to be reconstructed by the loan officer during the visit, implying more labor and time intensive micro-finance techniques, and thus adds cost. It likely will also negatively impact the size and term structure of the offered loan.
5. *Credit bureau infrastructure:*
6. **Credit bureaus can play a crucial part to overcome informational asymmetries, and as such particularly facilitate reaching out to new customers.** Providing a broad range of information on a potential or already existing client can facilitate the client’s eligibility for credit by (i) lowering the costs for financial institutions to inquire about the client, or to assess the borrower’s historical repayment capacity, and (ii) reducing the need and amount of required collateral for clients who are seeking credit. The information provided in credit bureaus is also useful for developing additional services, such as for example scoring models and market analysis, which can also facilitate a client’s eligibility for credit.
7. **Despite progress made in the last few years and receiving high marks in international benchmarks for its coverage, the credit bureau infrastructure in Bolivia is still fragmented, and only provides information on a segment of already banked client’s credit and repayment history[[113]](#footnote-113)**. As can be seen in Chart 21, there are currently 3 credit information entities operational in Bolivia, which collect both positive and negative credit related information. The “*Central de Informacion de Riesgo Crediticio*”, which is operated by ASFI, collects data for supervisory purposes to determine the level of debt in the regulated financial system[[114]](#footnote-114). There also exist two private credit bureaus[[115]](#footnote-115), which receive information on micro- and consumer credit from ASFI, while information on larger enterprise credits and mortgages is not transmitted and thus stays outside the private credit bureau sphere. One of the private credit bureaus also receives data from closed cooperatives and IFDs, and the other from smaller commercial enterprises. The collected data is thus still fragmented, and financial institutions have to invest additional resources to compile a client’s historic data. Furthermore, the credit bureaus do not collect additional positive information from i.e. utilities, social security agencies or telecommunications companies, but only capture already banked customers. Having data on unbanked clients could considerably facilitate the identification of new potential clients and thus the outreach of the financial sector.

**Chart 21: An overview over the credit bureau infrastructure in Bolivia**

*Source: World Bank*

1. **Furthermore, the quality and accessibility of the credit information collected by the Credit bureaus is not clearly regulated and supervised.** There are legal uncertainties regarding the privacy of the collected information, leaving room for interpretation which data could be made publicly available, shared with selected third parties, or should be treated as strictly confidential. The legal framework also does not specify the right of the individual to regularly assess the correctness of the registered information, and to request remedial action or removal of incorrect information. The absence of this clearly defined right to regularly assess one’s credit history can be particularly damaging considering the 10 years in which information on a client stays available in the credit bureau.
2. **Finally, credit bureaus are not authorized to develop auxiliary services to facilitate outreach models, market strategies and customer scoring.** In other countries, private credit bureaus provide services such as scoring models for individual customer segments, assess payment patterns and monitor non-payment of borrowers, and develop tools to detect identity theft early on. These additional services can help reduce costs for the financial institutions for identifying and monitoring borrowers, and thus can have both a positive impact on the costs and eligibility of borrowers, in particular those of lower incomes and with limited collateral. These additional services are currently prohibited for credit bureaus under the applicable regulatory framework, but considerations should be given to allow them.
3. *Regulatory framework and institutional infrastructure for the use of movable assets as collateral and creditor rights:*
4. **The legal framework and institutional infrastructure for movable collateral and creditor rights continues to be vastly deficient in Bolivia, leading to the above mentioned restrictions on real estate as collateral.** According to the Doing Business Indicators for 2010, Bolivia only fulfills 1 out of 10 internationally accepted legal and institutional requirements for a solid collateral and creditor rights infrastructure - a result that worldwide only Syria, Djibouti and Timor Lester share. Amongst the shortcomings in the framework are:

* Limitations in the type of movable assets that are acceptable;
* Absence of clear provisions for the borrower’s continued possession of the pledged collateral (i.e. for productive purposes);
* Lack of a unified collateral registry;
* Lack of priority of creditors to the collateral in and outside of bankruptcies;
* Vast deficiencies in enforcement of creditor rights, including out of court enforcement.

1. **Bureaucratic hurdles contribute to inefficiencies in arbitration, bankruptcy procedures, and judicial processes for contract enforcement.** While the costs to enforce a contract are with 33 percent of the claim not prohibitive like in other countries (i.e. Brazil or Indonesia), the administrative procedures for enforcing a contract are numerous and the process takes over 1.5 years according to the Doing Business Indicators. Out of court procedures exist, but can easily be blocked and therefore are not pursued.
2. **Several efforts to enhance the legal and regulatory environment for movable collateral and creditor rights in Bolivia have been undertaken in the last few years, but with no results.** Like in other countries, passing legislation on movable collateral is made difficult by fragmented legislation (i.e. provisions in the Commercial Code, Legal Codes etc.) and incompatibilities with constitutional provisions. Nevertheless, the revamping of Bolivia’s legal and regulatory framework, which became necessary due to the new Constitution, opens a window of opportunity to harmonize and reform the legal framework for movable collateral. Efforts should be made to put in place a separate framework law on movable collateral, which aims at allowing a broader range of movable collateral to be used, creating a unified database, and clearly determines the rights and obligations of the grantor of the collateral, the treatment of collateral in bankruptcy procedures and the possibility of using clearly defined out-of court procedures to claim the collateral in case of default. Addressing movable collateral without eliminating some of the shortcomings in creditor rights, in particular out of court enforcement, is unlikely to have a substantial impact on lowering the dependence on real estate for collateral.

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| **Text Box 5: Example of reforms to use of movable assets as collateral**  Since 2000, the governments of Romania and Slovakia introduced reforms of the movable collateral regime at the beginning of this century. The reforms made movable assets eligible as collateral, reduced documentation requirements for registration, gave priority to the creditor over the collateral, and facilitated out of court enforcements in case of default. Furthermore, unified registries for movable collateral were created. As a result, annual registration of property increased from around 65,000 in 2000 to over 530,000 in 2006 in Romania, and from 7,000 in 2003 to over 30,000 in 2007 in Slovakia (SOURCE: WB (2010), Secured transaction regimes and collateral registries, Washington DC, January 2010. )  More recently, Honduras has introduced a new law on movable collateral. It follows international best practice as established by the model law suggested by the Organization of American States. It is foreseen that the registry will be self-sustainable, its services relatively cheap and being a fully automatic on-line database, accessible even from remote areas of the country. After being launched in December of 2010, 400 registries were already reported as of February 2011. |

#### Barriers to affordability of loans

1. The strong dependence on collateral can be reduced through alternative funding products such as leasing and factoring, as well as schemes that help manage the risk of loans such as partial credit guarantees or micro-insurance[[116]](#footnote-116) services. These products can lower the costs of loans, and thus make external funding more affordable. The assessment shows that leasing and factoring are not sufficiently available in the system, largely due to deficiencies in the legal and regulatory framework, while products to reduce the riskiness of lending are only being developed and are not yet widely used. There is no indication that other loan conditionalities such as interest rates or available maturities make borrowing unaffordable.
2. *Available products:*
3. **The leasing market in Bolivia is underdeveloped.** Leasing is often perceived as a viable funding alternative for SMEs, as it requires only limited down-payments and no additional collateral. There are currently only two regulated financial institutions offering leasing in Bolivia, with a combined portfolio of USD 24 million. The two companies cater to different markets. BISA Leasing has a market share of over 80 percent, and caters to around 230 medium to large sized clients with an average outstanding leasing amount of around USD 85,000. Its business has largely stagnated in the last few years. In 2007, Fortaleza Leasing was founded with support from the IADB, and has reached by now over 200 small and medium sized clients, with an average leasing amount of USD 17,000. In January, another Bank (BNB) opened a leasing company. Finally, non-regulated entities such as car dealers, computer manufacturers and unregulated NGOs such as *Asociación Nacional Ecuménica de Desarrollo* (ANED) offer leasing services, but no data on their scale is available.
4. **Based on information provided during the mission, the market for leasing is constrained by a number of factors on the supply and demand side.** Potential clients seem to lack knowledge and understanding of leasing as an alternative to credit. Experience in other countries suggests that communication campaigns are needed to familiarize the population with leasing as an alternative funding instrument. On the supply side, the regulatory framework mandates that leasing companies have to operate as separate entities. In the past, leasing companies have experienced difficulties in mobilizing funds, and also reported higher funding costs, as they depend on medium- to longer term funds from other financial entities and on the issuance of bonds on the capital market. At the moment, however, with the ample liquidity in the system, these funding constraints have been negligible, and leasing expanded in the last half year by 7 percent.

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| **Text Box 6: Leasing reforms in Ghana**  In 2004, the new banking law allowed banks to directly engage in leasing activities as part of their regular operations, without the need to get a special license and operate as a separate financial entity. As a result, the number of financial institutions offering leasing services jumped to 9 in 2007 (up from 2 in 2004), with a combined portfolio of USD 71 mio in 2007 (compared to 1.65 in 2004). Their market share increased from 20 % of the leasing market to 65 % in 2007, replacing traditional non-bank lessors as the main provider of leasing.  *Source: IFC “Leasing in Ghana – A survey of the leasing market”, June 2008.* |

1. **The leasing framework in Bolivia should be updated.** The available legal framework is fragmented, and it is difficult to get a good overview over the regulations pertaining to leasing. In reaction to widespread misuse of the leasing instrument by banks at the end of the 90s[[117]](#footnote-117), the regulatory authorities amended the banking law through Decree 2297 in 2001, which prohibited financial institutions from providing financial leasing services, unless done through a separate financial entity. The need to create a dedicated and stand-alone financial entity poses a hurdle to entering the market, as it binds a significant amount of capital upfront. A dedicated institution furthermore does not allow to leverage existing institutional capacities (thus increasing costs), while it reduces the options to offer customers a wide range of services (thus reducing the quality of service to customers). In addition to this, any new entity that is interested in exploring the leasing market has to fulfill a number of upfront requirements that are costly and time-consuming such as an in-depth economic and financial feasibility study, which lowers incentives for piloting leasing products. Efforts to revamp the legal framework have already been undertaken, but so far unfortunately with no results.
2. **Similar deficiencies were reported with regard to factoring**. While the regulatory framework for the financial system already allows factoring to be used, the commercial code does not yet define what constitutes a “*factura cambiaria*”. This and the very limited use of invoices in the market de facto eliminate the use of factoring in the country.
3. **Partial credit guarantees are another alternative to overcome some of the collateral requirements, and could be particularly valuable for fostering lending to MSMEs[[118]](#footnote-118).** By providing a guarantee for the rapid reimbursement of a part of the loan amount in case of default, partial credit guarantees can substantially help lower the amount of collateral required by financial entities for lending, and through reducing the risk and costs of enforcing collateral and lowering capital and provisioning requirements for banks can translate into lower interest rates for borrowers. International experience such as in Chile (FOGAPE), Colombia (FNG) and Mexico (NAFIN) suggests that partial credit guarantees can play an important role for facilitating access to funding, but should ideally come at some cost for the borrower (for example payment of a certain percentage of the loan to be guaranteed), and benefit from well-trained credit officer and performance incentives for financial institutions to lower adverse selection of clients from the supply side.
4. **Several efforts were undertaken in recent years to launch micro-insurance products, in particular agro-insurance.** Experience in other countries indicates that these schemes oftentimes depend on government subsidies to be viable on the longer term, especially, if they are intended to cover more marginal (and risky) agricultural areas. In some countries, there are promising experiments with index-based insurance schemes, which cover only some very specific risks, and assess the incidence of triggers through means that reduce moral hazard (e.g. through weather-stations and/or local informants). Successful micro-insurance products in many instances also use the financial system or micro-finance NGOs to distribute the product to the client in combination with credit products, thus defining a clear (and limited) target group (borrowers) and purpose of the insurance (to facilitate access to funding). A voluntary micro-insurance scheme is currently being explored in Bolivia with support of PROFIN, involving communities in the roll-out of the program and the verification of claims, including an international reinsurer and a fall back solution on grant resources in the event of larger external shocks. Experience with uptake has so far been reportedly good, but the overall sustainability and applicability on a larger number of communities will have to be tested over time and will critically hinge on the number of risks being insured and the efficiency of the monitoring arrangements. It should also be noted that the new scheme under discussion is rather broad, and thus could lead to considerable contingent liabilities for the government if fully rolled out. Over time, the efficiency of the scheme with regard to the expected outcome on poverty levels should be assessed and its cost efficiency reevaluated based on other available alternatives to mitigate risks.
5. *Loan Conditions:*
6. **Under current conditions neither the available resource envelope nor the levels of interest rates appear to be significant constraints for the expansion of lending to the productive sectors.** The level of liquidity in the formal financial system increased significantly in recent years, in which the growth of deposits outpaced by large the growth of the loan portfolios, creating a strong competitive pressure on the interest rates for loans and also the overall lending standards[[119]](#footnote-119). Some smaller institutions may be hindered to offer longer term funding for investments as a consequence of term mismatch in their funding structure, or due to limits on unguaranteed loans implied by the regulatory framework, but overall there appears to be a strong interest in reaching out to new viable customers in order to reduce the high liquidity.
7. **A broad range of maturities are available**. Almost all interviewed financial intermediaries offer loans with medium to long terms. Maturities for mortgage loans can go up to 20 years, and for commercial loans frequently up to 10 years. Data on loan maturities is only publicly available for the banking sector, where short term loans reportedly comprise 20 to 25 percent of the loan portfolio. This is surprisingly low, in particular giving the high level of short-term deposits in the system[[120]](#footnote-120). Given the low level of investment financing, demand side interviews also do not point to large deficiencies in the available maturities in the system, but much rather point to the lack of grace periods as a restraint, and the problem associated with monthly installment payments that do not correspond to the income cycle of the borrower, in the case of loans to farmers and to businesses with string seasonality.

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| **Text Box 7: Core support that the government can provide for the development of agricultural insurance**   * + Develop an agriculture and weather database with sufficient number of stations throughout the country,   + Reduce post-disaster support to facilitate uptake of insurance products by the population, once an insurance system is in place,   + Establish a conducive regulatory framework for insurance companies, with easy access to international reinsurance markets,   + Launch education campaigns to raise awareness of targeted populations of product and the benefits they bring.   *Source: World Bank (2010), “Government support to Agricultural Insurance – Challenges and options for developing countries”, Washington D.C.* |

1. **Regulations are in place to protect the consumer, eliminate commissions on loan processing, and up-front costs of credit.** These costs are thus not a constraint for borrowers. However, the regulations have eliminated a potential source of income for financial institutions to cover incurred costs for financial intermediation, which will have to be covered through other sources such as the lending margins or can reduce the supply of credit to small, informal borrowers.

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| Chart 22: Effective spreads in local currency |
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| *Source: World Bank’s own calculations based on data from ASFI.* |

1. **Interest rates in the financial system continue to be below rates charged in neighboring countries.** Interest rates for commercial credit dropped from 11 percent in nominal terms to around 5 percent on average in 2009 (equivalent in real terms to a drop from 6 percent in 2005 to currently -1.7 percent), with some of the visited institutions reporting interest rates for commercial and real estate loans of around 4 percent for individual clients. Such favorable rates allow in principle for a significant expansion of long-term loans for investment, although this effect is to some extent mitigated by the fact that long-term loans usually have fixed rates only for the first few years, after which they convert into variable rate loans. Microfinance interest rates dropped even further, from 37 and 24 percent in 2005 to currently under 20 and 16 percent in nominal terms for the banking sector and finance companies. This is well below interest rates charged in other countries (see Chart 23), where at times interest rates of 50 percent and more are reported for micro-credits. The reduction in average lending interest rates was mirrored by a drop in deposit interest rates, leaving the interest margin at first view unchanged. However, the evolution of the interest margin does not reflect the significant shift that took place towards micro-credits and consumer loans with higher average interest rates. In the absence of the above mentioned drop in interest rates for the individual types of credits this shift in composition would have lead to an increase in average lending rates and thus larger interest rate margins.

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| Chart 23: Interest rate – an international comparison | |
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| *Source: World Bank’s own calculations based on data from ASFI data.* | |

## Ongoing and planned government programs

1. **The new Constitution provides guidance on the role of the government for fostering economic growth and the access to financial services by MSMEs[[121]](#footnote-121).** With the regulatory framework to be based on the criteria of equality of opportunity, solidarity and fair redistribution, Article 330 of the new Constitution foresees that the financial sector policy of the government should focus on (i) enhancing the demand for financial services from MSMEs, in particular small artisans, commerce, services, community organizations and producer cooperatives, and (ii) facilitate the creation of non-bank financial entities with social objectives in the productive sectors. Furthermore, Articles 334 and 336 aim to enhance and foster the creation of community groups and cooperatives in targeted economic sectors, and facilitate their access to credit and technical assistance.
2. **The Government has already passed a number of reform measures to fulfill this constitutional mandate.** In coordination with the Vice Ministry of Pensions and Financial Services as well as the Central Bank, ASFI passed or amended regulations to (i) specify the applicable definition for various sizes of enterprises, thus harmonized reporting standards in the financial sector, introducing the classification of MSME loans and guarantee requirements, and improving the quality of information on credit by size of enterprise, (ii) lower provisioning and capital adequacy requirements for productive sector credit, and raising their size and leverage limits, with the aim of increasing supply and lowering the interest rates charged, and (iii) establish a maximum time in which a credit application needs to be processed. Currently, discussions are underway with participation of the government to regulate interest rates and to create a dedicated public agricultural bank Most of these reforms are not addressing any of the determined bottlenecks, and the analysis thus raises doubt on whether these measures will be able to stimulate productive sector credit on a sustainable basis.. Finally, the Central Bank and ASFI have been at the center of efforts to bring stakeholders from the public and private sphere together to reflect on possible ways forward for stimulating the growth of productive sectors and made individual contributions to the discussion publicly available to raise awareness and transparency.
3. **Additionally, a number of government agencies, donors and NGOs support the development of individual sectors through the provision of grant funding, technical assistance and support for integration along value chains / clusters.** A number of sources of grant funding are available to the productive sector, which can help bridge initial shortcomings and jumpstart economic development, but – if not done carefully - can also crowd out the financial system through lower demand for credit. Attention should also be paid to facilitating the grant recipients linkage to the financial system, in order to allow them to graduate from grant funding on the medium term. With regard to reforms to address underlying economic bottlenecks, one visited IFD reported for example of a sectoral regulatory agency which “registers” credit contracts to facilitate contract enforcement. This proved to be a viable and un-bureaucratic way of enhancing contract discipline in the sector, and circumventing bottlenecks in the area of creditor rights. Interviews with associations, private sector companies and NGOs working with value chains indicated the existence of a variety of individual initiatives along those lines as well as available technical assistance facilities, but in their totality the initiatives appear fragmented, and not well coordinated. This reduces their effectiveness. A more coordinated approach appears thus to be warranted, with both the government agencies and private sector stakeholders (such as the Chambers of Commerce and Industry) in charge of alleviating constraints.
4. **The two public banks also launched a number of initiatives to directly and indirectly enhance access to credit of targeted sectors:**

***Banco Union***

1. **Having undergone substantial restructuring to clean up its balance sheet since 2004, *Banco Union* has now shifted its mission objective towards facilitating access to financial services for all Bolivians, with a particular focus on funding micro and small enterprises.** Formally being a joint-stock company, with the government holding over 97 percent of the stock, this first tier Bank does not yet have an official mandate from the government[[122]](#footnote-122) to expand access to finance. Its self-declared mission objective is to support economic development through fostering access to financial services. Having significantly improved on its core financial indicators since 2005 (see Annex 1), it has established linkages with IFDs operating in selected value chains and also increased its loan portfolio to public enterprises. This boosted its loan portfolio and the number of borrowers in the last year. *Banco Union* also helps implement a number of government programs, such as trust funds from the second tier bank BDP.
2. **The programs supported and developed by *Banco Union* speak of a significant dynamic and innovation within the bank, but attention has to be paid to not distorting the market**. The Bank launched amongst other initiatives (i) a fund to provide guarantees of up to 50 percent for loans of qualified MSMEs (PROPYME), and (ii) a micro life-insurance product with a maximum coverage of the equivalent of USD 4,000 to 40,000. In order not to create contingent liabilities for the government and introduce market distortions, attention needs to be paid that the various programs under implementation use the innovative capacity inside the Bank[[123]](#footnote-123) to pilot new products or test the feasibility of catering to certain underbanked market segments or geographic areas. Successful pilots could show the viability of catering to certain market segments or of certain products, and under fair market conditions could lead to an uptake and broad roll-out by private and cooperative financial institutions. At the current stage, this however is not always the case. Some of the cheap trust funds resources implemented with *Banco Union*’s support distort the market through focusing on lowering interest rates for existing micro-credits, instead of, for example, addressing the market gaps for investment loans resulting from lack of collateral that have been mentioned earlier[[124]](#footnote-124).

***Banco de Desarollo Productivo***

1. **The *Banco de Desarollo Productivo* (BDP)is officially under the Ministry of Economic Planning.** As it receives a substantial amount of its funding through trust funds and budgetary resources, the Ministry of Economy and Finance also plays an important role. Its public mandate is determined by the National Development Plan of 2007, declaring as its priority focus the development of the productive sector and of conducive financial conditions for credit. The BDP offers credit for on-lending to first tier institutions, which due to the prevailing low deposit interest rates and the ample liquidity in the system are currently only used by the IFDs. It also administers trust funds for the development of productive credit, which with on-lending rates of around 8 percent and grace periods of up to 2 years undersell the market. The trust funded loans are usually only processed by the involved first tier institutions, with the credit risk remaining with the BDP. This has led to the internal control of all loans by BDP prior to approval, and likely also creates disincentives for the financial entities to rigorously enforce payment from the borrowers[[125]](#footnote-125). Finally, BDP is in an advanced stage of launching a partial credit guarantee scheme to lower the dependence on collateral for clients from the productive sector.
2. **As in the case of *Banco Union*, the programs administered by the BDP can play a significant role for bridging market gaps, but can also lead to market distortions if not done well.** If loan contracts under the trust fund schemes are not enforced, these programs may even have a negative effect on the repayment culture of the targeted sectors. Despite being supervised by ASFI, the publicly available information about the BDP is not sufficiently detailed to provide information about the quality of its different loan portfolios, nor does it allow to determine if and to what extent the loans channeled through the BDP distort the market. The data also do not provide information if and how BDP addresses the core bottleneck in the system: the need for risk-sharing tools to lower the collateral requirements and help manage the riskiness of the loan portfolio. The latter will likely only be addressed once the partial credit risk scheme currently under development will be launched, and support for the establishment of an index-based agricultural insurance will be provided.
3. **Overall, there is a need to enhance transparency in the achievement of the public mandate**, which will require the setting of clear and limited mandates, the monitoring of measurable performance indicators towards those mandates[[126]](#footnote-126), the careful observation of non-performing loans, and regular readjustment of performance targets.
4. Summing up, there are a variety of government reform efforts underway, but the government might want to carefully evaluate their effectiveness and the effect of possible distortions on the other providers, in order to enhance the effectiveness of deployed public resources.

## Moving ahead - options to increase the supply of loans to MSMEs

1. **As seen, the growth of loan portfolios to MSMEs, in particular in the productive sector, faces significant demand side restrictions.** Growth prospects are particularly reduced by the overall very small size of businesses, the lack of appropriate business management tools and know-how, and the lack of stability and formality in their business relations and deficiency in the business enabling environment. Financing cannot solve such issues and it is therefore recommended that specific measures be taken to a) strengthen businesses, especially SMEs through training and well designed transfer of technology; b) promote the integration and strengthening of promising value chains and the establishment of more formal relations between their different stakeholders; c) promote the horizontal integration of small businesses so that they can provide larger quantities of goods and services; d) enhance the availability and reliability of financial statements and to train MSMEs in making use of the information they can provide, and e) address shortcomings in the business environment and investment climate. These are tasks that both the government and the private sector stakeholders need to address in a concerted and well coordinated manner to enhance efficiency and effectiveness. Pushing credit without at least simultaneously addressing those constraints will likely only lead to higher levels of individual debt, thus reducing the client’s further access to credit or negatively affecting the repayment culture in the country.
2. **In addition to this, it is advisable to implement measures that reduce existing uncertainties in the market**, by providing (and maintaining) a clear definition of the specific role of the state in each of the sectors of the economy, as well as of the pricing policies that will be followed by public enterprises in time.
3. **With regard to the financial sector, a number of efforts could be considered that would allow taking better advantage of the existing institutions serving MSMEs:**

*Demand side information on access and use of financial services*

1. **Concrete policies to promote the supply and use of financial services by productive MSMEs should be based on reliable data on the sector and the sources used for financing.** For this, it is recommended to include in the survey work planned by the government a dedicated module that looks at the access and use of financial services by MSMEs. In order to increase the usefulness of the information gathered for different public and private stakeholders, it would be advisable to unify the definition of the different types of enterprises by size[[127]](#footnote-127) among all public and major private institutions.

*Collateral and creditor rights*

1. **The difficulties faced by MSMEs to provide collateral for loans could be addressed through a variety of actions:**

* Assess in coordination with the different stakeholders options to facilitate the use of land (or its usufruct) in rural areas as collateral in the context of the current legislation. A very precise definition of the economic and social objectives that land has to fulfill might additionally contribute to reduce uncertainty and facilitate lending in rural areas,
* Legal, regulatory and institutional reforms should be undertaken to allow a broader use of movable guarantees in credit contracts and their enforcement. To facilitate the passing of new legislation, considerations should be given to passing a framework law that overrides the other legislations with regard to collateral and creditor rights,

*Reliability of financial information*

1. **In order to reduce existing information asymmetries and facilitate a stronger formality in doing business, the government could:**

* Improve the credit bureau infrastructure through (i) provision of information on all borrowers listed in SIRC to the private credit bureaus, (ii) reforms to allow inclusion of positive information from utilities, telephone companies etc., and (iii) reforms to clearly regulate and define the client’s right to the stored information,
* Support efforts to foster auditing and accounting in the country. This could be based on reform recommendations from an Auditing and Accounting ROSC, which may be conducted with World Bank support[[128]](#footnote-128).

*Innovation in the financial system*

1. **To facilitate the development and roll-out of innovative credit products that eliminate some of the collateral requirements or reduce risks in lending, the government should embark on reforming the legal and regulatory framework for leasing, and factoring, and provide direct support for the development and availability of risk mitigating products such as partial credit guarantees and index-based or micro-insurance products.** Legal reforms would best be achieved through switching from a “negative” regulatory framework (explicit exclusion of activities) into creating an enabling framework (permitting new products pending special approval by ASFI). The latter approach would be flexible to accommodated innovation while still leaving room for ASFI to supervise and intervene where necessary.

* In the area of leasing, ASFI should consider allowing leasing operations to be conducted by a dedicated unit within existing financial entity instead of mandating the creation of a separate financial entity. The integration of leasing within the financial entity would allow for cross-selling of products and reduce costs for marketing and outreach to clients, while the existence of a dedicated unit with (i) specialized staff, (ii) a clearly developed product and (iii) adequate accounting and control systems in place would prevent the misuse experienced in earlier years. In the area of factoring, the definition of an invoice would have to be clarified, and the legal and regulatory framework assessed to determine additional shortcomings that prevent the use and roll-out of this product. Implementation of the new frameworks could then be supported through TA and dedicated funding for the development of these products in the financial sector.
* A partial credit guarantee fund could play an important role to compensate for missing guarantees. The partial credit guarantee could for example, as already contemplated, be hinged administratively at the second tier bank BDP. It should be an autonomous judicial entity with separate and sufficient capital endowment and a mandate for operational self-sufficiency, clear and streamlined administrative rules in particular for pay-outs, and adequate supervision of the financial system supervisory body ASFI. This should include publication of performance and results for transparency and public oversight.
* The government and business associations can also play an active role in supporting the use of these innovative lending instruments. It can for example foster leasing and factoring as part of reforms of the value chains, where standardized leasing products could be developed for certain types of machinery, and factoring could be fostered through a stronger integration of the various players along the value chain. Furthermore, information campaigns could be helpful to familiarize the population with these instruments.

*The roles of the public banks*

1. **Experience in other countries such as Bancoldex (Colombia), Mexico (Finrural) and Germany (KFW) suggest that the setting of a clear and limited mandate (including defining a target group or sector), transparent governance structures and enforceable budgetary limits are key for maintaining a healthy public banking system while making progress towards eliminating determined bottlenecks.** Particular attention needs to be place on preventing market distortions, and on addressing only those areas in which prior analysis has determined a clear market gap[[129]](#footnote-129):

* There is a need to redefine and reorient the role of BDP, moving it fully away from first tier lending at subsidized rates and refocusing it on (i) facilitating the introduction of innovative products that address market failures to its target sectors and on (ii) areas where economic and social benefits exceed the costs of the intervention. As done by some pubic banks in other countries, the BDP could for example foster the development of targeted products to individual sectors with the aim to familiarize the financial entities with the peculiarities of the respective sector, needed credit conditionalities and repayment cycles, and available guarantees. This could be done through risk sharing models. This would reduce piloting costs and risk perception in financial institutions, and open up new sectors to financing. BDP could also play a pivotal role in launching leasing, or factoring, and lowering the riskiness of loans through issuing partial credit guarantee for credits to selected sectors or geographic regions.
* The government also needs to clarify the role that *Banco Union* will play for the development of the financial system. As recent reform measures indicate, there is the risk that the *Banco Union* will be burdened with too many roles, and loose traction and focus. As the bank is operating on the first tier, a particular focus needs to be placed on not distorting the market through unduly low interest rates and generous loan conditions, which cannot viably be matched by the private financial system and on the longer term could lead to contingent liabilities of the government. Similar recommendations would apply to any new development bank, if the government follows through on its intention to create such a new public financial institution.
* For all direct government interventions, the programs need to be developed based on a prior needs assessment (i.e. as determined by the above demand side survey), and include the setting of a monitoring and evaluation framework to track their effectiveness, the uptake of those products in the private sector on their own balance sheet, and actual achievements in the real sector. A sunset clause for individual product lines would be helpful to maintain the innovative capacity of the institutions.

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**Annex I**



*Source: World Bank’s own calculations based on ASFI and FINRURAL data. For comparability purposes, absolute figures were adjusted to reflect the transformation of Banco FIE (from SLA to bank) and the exit of Citibank from Bolivia.*

1. The Financial Sector Assessment Program (FSAP) update incorporates some of the suggestions made in this report, albeit without the complete background information and details. [↑](#footnote-ref-1)
2. This report is the final delivery for the Financial Sector Notes ESW (Economic Sector Work) as approved in January 2010. With view to the recent FSAP mission, the focus of the report shifted towards assessing market composition, regulations, and available financial infrastructure and government policies with view to outreach of the financial system to rural areas and to the productive sector. This is the current focus of the government in the financial sector. [↑](#footnote-ref-2)
3. See further discussions on the available surveys in Chapter 5 and 6. [↑](#footnote-ref-3)
4. In Bolivia, the formal microfinance sector includes 3 microfinance banks, 5 finance companies and as of December 2010 25 open cooperatives. [↑](#footnote-ref-4)
5. FINRURAL (*Federación Nacional de Instituciones Financieras de Desarrollo)* is an association which represents 13 IFDs and supports their development through implementation of joint infrastructure projects such as cash transport systems, common data platforms etc. [↑](#footnote-ref-5)
6. On the other side, pushing lending alone would not contribute significantly to enhance production and productivity of firms, if not linked with reforms to enhance the integration of the sectors, improvements to the business environment and market access of clients. [↑](#footnote-ref-6)
7. This is based on the share within all registered financial entities (be they regulated or not). However, the data are not netted between the formal financial system and the unregulated financial system. Given the differences in clientele and loan size in IFDs it can be assumed that there is not a large overlap between their clients and those of the formal financial system. However, an overlap between the clients from closed cooperatives and the financial system is likely, as experience in other countries shows. [↑](#footnote-ref-7)
8. According to a recent study, the IFDs are the group of financial institutions that cater to the segments with the lowest income in Bolivia (see Alem et. al, ILO, 2011) [↑](#footnote-ref-8)
9. For more detail, see forthcoming note on the regulatory framework for cooperatives and the transition process into the regulatory sphere, which was delivered and discussed with the authorities. Furthermore, experience in Mexico with the transition of savings and loan institutions and cooperatives suggest that incentives along the way need to be provided to encourage and speed up the transition process, as well as technical assistance provided to facilitate the setting up of appropriate internal organizational structures and processes. [↑](#footnote-ref-9)
10. It should be noted that the geographic reach of the formal financial system will be significantly expanded through the ongoing incorporation of the hitherto unregulated closed cooperatives and the IFDs under the purview of ASFI. [↑](#footnote-ref-10)
11. ATMs are for example rather expensive for a financial institution, as (i) money transport services are expensive, and (ii) ATMs need to be rather frequently reloaded due to the requirement to offer 10 and 20 Boliviano bills, while (iii) income through commissions is eliminated for own clients. The regulation on service points mandates high security standards. The latter might not be necessary in some of the smaller villages, where banking is mostly based on pre-established trust and thus protected through the community. Leaving the security standards to a larger extent at the discretion of the financial entity will likely lower some of the hurdles for outreach. Finally, consumer protection measures such as reducing waiting times to 30 minutes can pose a problem for branches, which only at certain peak times, such as for the paying of cash transfers, report a higher volume of client traffic. [↑](#footnote-ref-11)
12. This refers to credit classified by all types of financial institutions as microcredit. It is thus different from the share of micro-finance institutions in deposits and credits as discussed in Chapter 2, paragraph 8. [↑](#footnote-ref-12)
13. Agriculture, forestry, manufacturing industry and extractive industries. [↑](#footnote-ref-13)
14. In this context, ASFI’s recent changes to the prudential framework, which explicitly introduce movable collateral as guarantees for loans, is a positive first step. [↑](#footnote-ref-14)
15. The new constitution generally confirms the right of the individual to security in property possession. However, Article 397 establishes that the government has the right to repossess land if the owner is not fulfilling its social or social-economic role. Furthermore, Article 396 assigned an explicit role to the government for regulating the land market, in particularly preventing a large land ownership. It is not yet clearly defined under which circumstances this provision can be applied The compliance with the requirement to fulfill a social and economic role is verified every two years by the government, and has already lead to withdrawal of land rights in selected cases. [↑](#footnote-ref-15)
16. The government is currently revising the country’s financial system law to adapt it to the new Constitution, and there are ongoing discussions on the introduction of interest rate caps, and on increasing the role of the government in the financial system through for example the creation of a new bank. These developments and discussions are not considered in this document. [↑](#footnote-ref-16)
17. The Central Bank and ASFI have since launched regulations to clarify the delivery of financial services by mobile network operators. [↑](#footnote-ref-17)
18. Ideally using the categorization established recently by ASFI for this purpose. [↑](#footnote-ref-18)
19. The Bolivian authorities are considering carrying out an auditing and accounting ROSC with support of the World Bank [↑](#footnote-ref-19)
20. In larger part due to strong demand for its hydrocarbon products, which account for more than a third of exports. [↑](#footnote-ref-20)
21. End 2009, based on INE data. [↑](#footnote-ref-21)
22. Amongst the planned measures were (i) the facilitation of access to financial services for MSMEs (ii) the development of business and market intelligence service for MSMEs (through Pro Bolivia) as well as measures to promote exports (through *Promueve Bolivia*), and (iii) support to enhance the quality of production through standards and certification services. [↑](#footnote-ref-22)
23. In October 2010, ASFI for example organized a workshop with stakeholders on productive credit, and published the presentations of the participants on its internet page. [↑](#footnote-ref-23)
24. Expressed explicitly as a focus topic during two missions in 2010, as well as for the FSAP update conducted in March 2011. [↑](#footnote-ref-24)
25. In December 2010, one additional cooperative has become fully supervised by ASFI. Please note that some sections of the report are based on data for November 2010, as this was the original dataset provided by the authorities for this assessment, and thus only comprise 24 cooperatives. [↑](#footnote-ref-25)
26. *Cooperativa Trapetrol Oriente* was intervened in 2005 after having lost close to 70 percent of its capital. [↑](#footnote-ref-26)
27. Banco Solidario, Banco Los Andes and Banco FIE. [↑](#footnote-ref-27)
28. FINRURAL (*Federación Nacional de Instituciones Financieras de Desarrollo*) is an association which represents 13 IFDs, and also supports their development through development of joint infrastructure such as cash transport systems, common data platforms etc. [↑](#footnote-ref-28)
29. Until recently, ASFI did not have a clear mandate to collect this data, as the DGCOOP is formally the entity in charge of licensing any cooperative and collecting the basic data on these entities. As in many countries, given the number of financial and non-financial cooperatives, this is a vast task for which not sufficient budgetary resources are available. [↑](#footnote-ref-29)
30. The data are not netted between the formal financial system and the unregulated financial system, but given the differences in clientele and loan size in IFDs it can be assumed that there is not a large overlap between their clients and those of the formal financial system. However, an overlap between the clients from closed cooperatives and the financial system is likely, as experience in other countries shows. [↑](#footnote-ref-30)
31. According to a recent study, the IFDs are the group of financial institutions that cater to the segments with the lowest income in Bolivia (see Alem et. al, ILO, 2011) [↑](#footnote-ref-31)
32. See forthcoming note on the regulatory framework for cooperatives and the transition process into the regulatory sphere, which was delivered and discussed with the authorities. Furthermore, experience in Mexico with the transition of savings and loan institutions and cooperatives suggest that incentives along the way need to be provided to entities willing to adjust to encourage and speed up their transition process, together with technical assistance to facilitate the setting up of appropriate internal organizational structures and processes. [↑](#footnote-ref-32)
33. Source: World Bank, FinStat database. [↑](#footnote-ref-33)
34. See further discussions on the available surveys in Chapter 5 and 6. [↑](#footnote-ref-34)
35. Both credit and deposit growth rates and ratios to GDP are based on data from the IMF IFS database, to make it internationally comparable. [↑](#footnote-ref-35)
36. Defined here as current and savings accounts. [↑](#footnote-ref-36)
37. Source: data provided by ASFI, this figure does not include the 325,280 accounts of the unregulated closed cooperatives. [↑](#footnote-ref-37)
38. The comparison also holds when only looking at banking accounts in the system. The data for banks alone is more comparable across countries as in many countries worldwide non-bank financial institutions are partially regulated by other regulatory agency or not regulated at all, leading to a gap in availability and reliability of data for the international comparison. [↑](#footnote-ref-38)
39. Measured here as GNI *per capita* based on the Atlas method. Source: World Bank data. [↑](#footnote-ref-39)
40. This is in contrast for example with countries like Paraguay, where the formal financial system has hitherto mostly focused on larger borrowers, and only recently is starting to cater to micro-and small enterprises on a larger scale. [↑](#footnote-ref-40)
41. Collateral is in many instances not needed for working capital, as the loan amounts are smaller and in many instances are done without requiring a real guarantee. [↑](#footnote-ref-41)
42. As branch are counted the following 5 service points defined by ASFI as having a permanent location and being fielded by own staff: *oficina central*, *sucursal*, *agencia fija*, *oficina externa* and *oficina ferial*. [↑](#footnote-ref-42)
43. Central Bank of Bolivia (2009a), “*Informe mensual – Julio 2009. Encuesta sobre uso de instrumentos de pago alternativos al efectivo en Bolivia*”, *La Paz* (2009), and Central Bank of Bolivia (2010), “*Informe mensual, Sistema de pago – Agosto 2009. Encuesta sobre pagos electrónicos al sistema financiero*”, *La Paz*, (2009). [↑](#footnote-ref-43)
44. The Central Bank’s survey on payment systems (August 2009) shows that 91 percent of banks, 43 percent of SLAs, 67 percent of finance companies and only 27 percent of the cooperatives offer transfers to third parties as a service. [↑](#footnote-ref-44)
45. The relatively high Herfindahl Index in 2008 still reflected the merger of Banco Mercantil and Banco Santa Cruz, which had significantly increased the market share of the largest banks.. Since then, 2 more finance companies converted into banks, which led to the drop in the reported index [↑](#footnote-ref-45)
46. The difference between the concentration ratios from Chart 3 and the ones in the text stems from different sources. For international comparison purposes, the chart was elaborated based on the World Bank’s Finstat database, which takes into account a sample of 10 banks reporting to *Bankscope*. The ratio in the text was calculated based on ASFI data. [↑](#footnote-ref-46)
47. Brazil, Chile, Colombia, Costa Rica, Ecuador and Mexico show for example similar market shares for the largest banks, while El Salvador, Guatemala, Peru and Uruguay report higher levels of concentration within the banking sector. The World Bank FinStat database also shows similar or higher levels of concentration for regional and income level peers, and market shares of close to 80 percent for countries with similar structural features. It should however be noted that the concentration ratio can only provide an indication into competition, as the market size also plays an important role for the number of players that can sustainably operate in a market, with some of the larger economies like Mexico and Colombia considering similar concentration ratios to be an issue. The H statistic also indicates higher concentration in the Bolivian market, but like the market concentration ratios does not reflect the small size of the formal economy, and the importance of non-banks for the delivery of financial services. [↑](#footnote-ref-47)
48. It is interesting to note in this context that there is a progressive transition of some entities from IFDs to Finance Companies and from Finance Companies to Banks. Other entrants, different from upgrading microfinance oriented entities may find that the Bolivian market is not attractive due to its small size and ongoing legal adjustments. [↑](#footnote-ref-48)
49. It should be noted that in 2008 and 2009 the rates of return were above the regional averages, as profitability in many other countries in the region was negatively impacted by the international economic and financial crisis, while the financial system in Bolivia benefited from higher interest rates of government paper. [↑](#footnote-ref-49)
50. For example, the income statements for the finance company *Prodem* and the SLA *La Paz* show higher commission income through non-intermediation related services such as the delivery of conditional cash transfers in the case of PRODEM, and the payment of utilities in the case of SLA *La Paz*. [↑](#footnote-ref-50)
51. Several aspects contributed to these high levels of liquidity. Since 2005, the government increasingly shifted its debt from international markets into the national market, with a corresponding increase in domestic interest rates for “*letras de tresoria*”. This in particularly led the “traditional” commercial banking sector and the SLAs to increase their liquid assets held at the Central Bank to over 25 percent of assets. In 2009, the Central Bank shifted its monetary policy from contractive to expansive with low interest rates, which reversed this trend. Commercial banks and SLAs now report assets at the Central Bank of 16 and 9 percent respectively. Another important factor driving the high levels of liquidity has been weaknesses in the investment climate as discussed in Chapter 6, the perception of higher uncertainty in the international and national economic system, as well as the strong growth of deposits, which was not matched with equal growth in credit due to the lack of demand for credit in combination with supply side driven difficulties in quickly expanding the base of borrowers due to the high levels of informality in the economy and the small scale of most business. [↑](#footnote-ref-51)
52. ASFI only recently (November 2010) introduced a new regulation to limit investments in international assets to 50 percent of the entities capital. Given the lack of investment alternatives in Bolivia and the currently low domestic interest rates for investments, this will likely reduce profitability of the entities in the short-term. [↑](#footnote-ref-52)
53. Between 20-30 percent of the deposits in individual commercial banks are being held by around 100 depositors and in the case of the public bank 25 percent by only 25 depositors. [↑](#footnote-ref-53)
54. Cooperatives, finance companies and microfinance banks also saw an increase in sight deposits, but over 50 percent of their funds continue to be in the form of more stable term deposits and their depositor base tends to be more broadly diversified over a larger number of depositors. [↑](#footnote-ref-54)
55. The investment policy issued under Law 65 does however allow investments in bonds issued by banks, and also foresees that the investments of the pension funds be well diversified and seek the highest possible returns on investments within certain risk categories. [↑](#footnote-ref-55)
56. The regulatory framework limits the net open position in foreign exchange to 70 percent of capital. [↑](#footnote-ref-56)
57. In the banking sector, less than 700 borrowers account for 30 percent of the loan portfolio, highlighting a significant concentration risk for individual banks. Stress results indicate that some banks would fall under the capital adequacy ratio if 5 of their largest borrower would default. [↑](#footnote-ref-57)
58. There is no information available on the levels of non-performing loans for the government programs, which are channeled through the banking system. Hearsay suggests that these programs have much higher non-performing loans, but as they are in general passed on to the BDP trust funds, they do not show in the books of the financial entities. [↑](#footnote-ref-58)
59. The data do not include information about the trust funds mentioned in the previous footnote. The aggregated NPLs, especially of the public banks would most likely be much higher than reported here if the figures were to include the trust fund portfolios. [↑](#footnote-ref-59)
60. The law for banks and financial entities (Law 1488) and its regulations place restrictions for non-bank financial entities on foreign trade operations, capital investments in securitization companies, the administration of investment funds and factoring and leasing operations. Additionally, non-bank financial institutions need to get permission to issue current accounts and credit cards. Those permissions have so far not been issued, although some entities have applied for it. [↑](#footnote-ref-60)
61. This is for example the case with recent regulations to foster credit to the productive credit for which provisioning requirements in the case of performing loans were lowered in the hope of incentivizing lending to the sector and lowering its costs. Implementing this leads to provisioning levels that are not in line with the over the years consistently higher non-performing loan ratios for the productive sector (see Chapter 6), and thus can encourage inappropriate risk management until the loan becomes non-performing and the costs for no-longer reduced levels of provisioning have to be shouldered. Similar distortions arise from (i) the recently introduced favorable risk weights for the capital adequacy calculations introduced, and (ii) higher capital leverages and loan size limits for productive credit loans. [↑](#footnote-ref-61)
62. The chapter on access to finance as well as the technical note prepared on the transformation of closed cooperatives into the regulatory sphere provides more in-depth assessment on the rational for the suggested reforms. [↑](#footnote-ref-62)
63. A model code is for example available from WOCCU (World Council of Credit Unions), and several countries such as Brazil have introduced one in the last few years. [↑](#footnote-ref-63)
64. Resolution No. 693 / 11 of September 27, 2011 already introduced additional forms of collateral under the rubric of guaranteed loans. This includes warrants, letters of credits, pledged movable collateral and guarantee funds. [↑](#footnote-ref-64)
65. The list of information required on a regular basis from the various financial entities is long, and in some instances appears to be excessive. Regulated entities have to submit information on daily, weekly, monthly and annual basis. The requested data allows ASFI to develop a substantive picture of the financial health of each financial institution, and thus helps ASFI to fulfill its mandate of financial supervision. However, ASFI might want to reconsider whether the depth, wealth and frequency of requested information is commensurate with the risk to stability posed by smaller financial institutions such as newly regulated closed cooperatives and IFDs. [↑](#footnote-ref-65)
66. Unless concern based on the provided financial soundness indicators warrant a more frequent supervision of an individual institution. [↑](#footnote-ref-66)
67. Bolivia does not have a consistent definition of what is “rural”. The statistics office INE uses a comparatively narrow approach and defines as rural any locality with less than 2,000 inhabitants leading to Bolivia reporting a comparatively low share of rural population (37 percent, compared to 58 percent for the region). ASFI itself does not yet have a formal definition of what constitutes rural, while FINRURAL or ASOFIN each have a distinct agreement within their membership regarding which localities to label as rural. Others classify anything outside of the 9 departmental capitals or the 4 largest cities as “rural”, or only consider those households that live outside of any settlement. As there is no consistency in the data on the rural sector, interpreting the data from various data sources has to be done with care. [↑](#footnote-ref-67)
68. The share of the rural population depending on agriculture declined slightly over the last years from 84 percent in 1999 to currently 77 percent, reflecting emerging employment opportunities in industrial manufacturing, construction and commercial activity in rural areas. [↑](#footnote-ref-68)
69. Based on World Bank data. Some of the gap has in the meantime been bridged. ENTEL for example reports that around 70 percent of the population now is covered by some form of telecommunication network, but problems continue to be reported with the reliability of the service coverage, including in the larger cities. [↑](#footnote-ref-69)
70. According to information received during the mission, the installation of a satellite dish costs between USD 600-1,200, and the monthly fees for its operation around USD 250 - 300. [↑](#footnote-ref-70)
71. The data up to 2011 confirms this trend, but was not provided in sufficient granularity to do the more detailed assessment. Furthermore, with the transformation of the *Fondo Financiero FIE* into a microfinance bank, the data on the outreach in between 2010 and 2011 would show significant swings between banks and finance companies, and thus would not reflect correctly the trend. [↑](#footnote-ref-71)
72. Based on the regulatory framework, “*Agencia fijas*” are mini-branches installed in a separate location that report and depend on either the headquarters or regional branch of a financial entity and that need prior authorization from ASFI. They can offer the full range of services. “*Cajas externas*” and “*ventanillas*” are service points that are housed inside a third party location, and can only offer transactional services related to credit, savings and bill payments, or only bill payment in the case of a “*ventanilla”*. “*Cajas externas*” and “*ventanillas*” do not need prior authorization from the authorities. [↑](#footnote-ref-72)
73. The increased number of service points in the financial system lead to some bundling of service points in selected areas, such as for example observed in *Punata*, at one of the cross-roads in *El Alto*, in *Quillacollo* and in *Copacabana*. The study on the access to finance in Bolivia carried out by ASFI in 2009 also confirms some saturation in selected cities. [↑](#footnote-ref-73)
74. The regulatory framework i.e. imposes that mobile branches need to receive prior authorization from ASFI, be an armored vehicle and equipped with “sufficient” prior communication technology, a safe, security installations such as video systems and two security guards. [↑](#footnote-ref-74)
75. The reduction of direct costs for the client would however not be relevant in Bolivia, as the regulation eliminates these commissions. [↑](#footnote-ref-75)
76. Resolution ASFI 141/2011 was passed in February 2011. [↑](#footnote-ref-76)
77. The RTGS was initially only open to banks and the 2 biggest SLAs, but with resolution RD 109/2007 is now also open to financial entities supervised by ASFI (formerly SBEF). However, only a limited number of non-banks have actually installed the necessary technical requirements, as those can be costly and given the limited demand for electronic payment options by the population might outweigh the costs with maintaining the current system of going through banks. Only those with access to the RTGS can receive cash at the 3 Central Bank windows in the country. [↑](#footnote-ref-77)
78. The settlement of the balances for the network provider is done through a centralizing bank. [↑](#footnote-ref-78)
79. Only entities that have access to the RTGS can receive cash at the 3 Central Bank locations throughout the country, and interbank transfers and liquidity support cannot be directly and in real time be provided. [↑](#footnote-ref-79)
80. One cooperative for example reported costs for the issuance of debit cards through a bank of USD 3.50, annual fees of USD 5, and transaction costs charged by the corresponding bank between USD 0.14 to USD 1. These fees provide an interesting additional income for banks, but levy costs on the cooperative which due to the regulation on commissions cannot be passed on to the client and thus discourages the provision of debit cards to clients. [↑](#footnote-ref-80)
81. It is estimated that the new system will incur costs per card of USD 1.5, compared to 5 under the current system. [↑](#footnote-ref-81)
82. Most remittances are being sent from Argentina, USA and Spain. Money transfer providers such as Western Union have not direct representation in Bolivia, but much rather use existing infrastructure and financial institutions to cater to the market. [↑](#footnote-ref-82)
83. For example, several persons interviewed indicated that they pay their employees in cash, and also go to their financial institution in person to pay in cash for their utility bills. They maintain significant cash at home for the various upcoming financial needs, and only deposit extra funds, which they plan to save for the longer term, into their account at a financial entity. [↑](#footnote-ref-83)
84. Other examples show that hiring someone from the same locality to work in the new branch can help establish trust in the community. [↑](#footnote-ref-84)
85. For example, the requirements to be able to service clients within a certain time limit, to have a consumer protection trained agent in every agency, to eliminate any commissions on regular financial service provision and to condition the opening of an urban branch to the opening of a rural branch can in its totality discourage financial entities to expand their coverage or test new approaches to service delivery. Furthermore, the stringent regulatory framework can pose a hurdle for the transition of closed cooperatives and IFDs into regulatory agencies, as most of those entities do not yet fulfill any of the mandated security requirements and consumer protection requirements for branches. Without “easing” and sequencing of the transition, this can lead to closing of service points instead of enhancing the service delivery. [↑](#footnote-ref-85)
86. As of February 2011, the government mandates that all purchases above the equivalent to USD 7,000 should be paid with a payment instrument (check or debit / credit card) authorized by ASFI. While this regulation is in the first place geared towards eliminating tax evasion and unfortunately implies that banks will have to open their books to tax authorities for the purpose of tracking income and transactions, regulations of this kind could contribute to lower the cash dependency of the economy and familiarize the population with more modern means of payment. Using these forms of regulations should however only be done in very limited circumstances. [↑](#footnote-ref-86)
87. Initially public employees had the option to have their salaries deposited at three commercial banks. As of March 2011, the options were reduced, with *Banco Union* as the only entity allowed opening payroll accounts for public employees. [↑](#footnote-ref-87)
88. An unregulated closed cooperatives visited did for example not count with most of the suggested security requirements by the regulation, and still enjoyed the trust and business from the village. Similar experiences are reported from other countries where particularly in societies with a strong culture of trust financial institutions are “protected” through the population itself. [↑](#footnote-ref-88)
89. Prior to publication of the report, a first set of regulations of this nature have been issued by the Central Bank and ASFI. [↑](#footnote-ref-89)
90. The agricultural survey in 2008 for example includes a question on whether the agricultural firm has access to financing, and if so whether from a bank, cooperative, NGO or other sources. The compiled data published on the web however do not include the information. [↑](#footnote-ref-90)
91. See Article 334 of the new constitution, which however does not yet clearly define which are to be the core sectors in which the government is to become active. [↑](#footnote-ref-91)
92. An evaluation of strategic alliances, conducted as part of the Bank’s non-lending technical assistance (NLTA) program for Bolivia highlighted, that enterprises in the textile industry reported lower and more volatile sales in part due to the expiration of the Andean Trade Promotion and Drug Eradication Act but also due to the impact of the economic crisis in major industrialized countries. Other sectors such as manufacturing also reported underutilized capacity, strong foreign competition and high costs for inputs. Finally, rigid labor market regulations and competition from the large informal sector also impact the profitability of companies and reduce demand for credit. This lack of internal demand for credit mirrors the data on investment, with national private investment only accounting for 13 percent of overall investment, compared to 53 and 34 percent for foreign direct and public investment respectively. [↑](#footnote-ref-92)
93. World Bank Data. [↑](#footnote-ref-93)
94. Accordingly, the number of borrowers with micro-loans (below USD 1,000 and less) dropped in absolute terms over the last few years. [↑](#footnote-ref-94)
95. Since finalization of the report, ASFI has issued new regulations pertaining to micro, small and medium sized credits. [↑](#footnote-ref-95)
96. It should be noted that the data on credit by sector includes consumer and housing loans for non-commercial purposes, as the entire loan portfolio is classified by economic sectors and not as is usual first by type of loan (i.e. commercial, mortgage etc) and then by sector for commercial credit only. This makes an assessment of the data less meaningful, and likely overstates the share of the credit that is being used for productive purposes. The supervisory agency should consider changing the publicly reported sectoral classification of credit into the internationally used four broad categories of commercial, mortgage, consumer and micro-credit, and only subdividing the data for commercial and microcredit further along the lines of the sectoral classifications used in the national statistics. [↑](#footnote-ref-96)
97. INE, *Estadisticas Nacionales*. [↑](#footnote-ref-97)
98. According to the statistics institute INE, the classification of microenterprises is done by number of employees, with below 5 being considered a micro enterprise, between 5-14 a small, between 15-40 a medium and above 40 a large enterprise. This definition is not uncommon in other countries, although many countries use for micro-enterprises the definition of up 10 employees, or also include information on sales volumes in the definition. [↑](#footnote-ref-98)
99. Defined here as agriculture, extractive industries, industry (manufacturing). [↑](#footnote-ref-99)
100. See Saavedra García, Moreno Uribe, Hernández Callejas (2008). [↑](#footnote-ref-100)
101. The number of enterprises listed in *Fundempresa* almost doubled between 2006 and January 2011. [↑](#footnote-ref-101)
102. Inconsistencies exist for example in the definition what constitutes a micro-enterprise. While INE uses the number of employees to determine the size of enterprises, banks until recently used for example the size of loans to classify the borrower, while other agencies use a mixture of sales, employees and other indicators to determine the size of an enterprise. ASFI recently worked on harmonizing the definition used for the various sizes of entities, so that the data should at least be homogenous within the financial sector since September 2010. [↑](#footnote-ref-102)
103. Schneider (2004) “*The Size of the Shadow Economies of 145 Countries all over the World: First Results over the Period 1999 to 2003.* Discussion Paper Series. Institute for the Study of Labor. Discussion Paper No. 1431. Diciembre 2004. [↑](#footnote-ref-103)
104. See for a more detailed discussion of informality World Bank (2007), with some international comparison based on data provided by Gasparini y Tornarolli (2007). [↑](#footnote-ref-104)
105. An analysis by the IADB (2006) shows that the level of informality is particularly high in the productive sectors, with 88 percent of the agricultural enterprises and 85 percent of the industrial sector not having a RUC. [↑](#footnote-ref-105)
106. See World Bank (2007), and IADB (2006). The study of the IADB for example suggests that the average productivity was Bs. 699 in 2001, compared to over Bs. 17,000 for large enterprises. [↑](#footnote-ref-106)
107. See IFC (2006), page 2 and 7. [↑](#footnote-ref-107)
108. Or the immovable collateral is too small to justify the frequently larger costs for registering immovable collateral. [↑](#footnote-ref-108)
109. Some research shows that countries with a solid secured transaction infrastructure have on average credit to GDP ratio of 60 percent, compared to 30 percent for countries that lack the infrastructure. Furthermore, borrowers in industrial countries tend to get 9 times larger loans, with 11 times longer maturities. [↑](#footnote-ref-109)
110. Until recently, the limits for group guarantees were BS 84,000 (~ USD 12.000) and BS 54,000 (~USD 8,000) for unregistered movable collateral. In September 2011, ASFI issued Resolution No 693 which updates these limits, introduced partial credit guarantees, warrants and letters of credit as acceptable guarantees, and includes definition for housing loans. It now allows microcredits to the productive sector to be issue without guarantee for up to BS 112,000. The movable guarantees do not count toward the maximum capital limits established by type of loans for non-guaranteed loans. [↑](#footnote-ref-110)
111. The new Constitution generally confirms the right of the individual to security in property possession. However, Article 397 establishes that the government has the right to repossess land if the owner is not fulfilling its social or social-economic role. Furthermore, Article 396 assigned an explicit role to the government for regulating the land market, in particularly preventing a large land ownership. [↑](#footnote-ref-111)
112. I.e. Micro-entrepreneurs might have to show individual receipts to the loan officer, who then has to construct manually the financial situation and the income stream based on this. [↑](#footnote-ref-112)
113. This section benefits from an in-depth assessment of the credit bureau infrastructure in October 2010, which was arranged and financially supported through this Economic and Sector Work in combination with additional Financial Sector Reform and Strengthening Initiative (FIRST) funding. [↑](#footnote-ref-113)
114. This has not yet led to the development of more sophisticated stress-tests to determine the robustness of individual financial entities to macro-economic shocks and the resulting deterioration of the quality of the credit portfolio. [↑](#footnote-ref-114)
115. INFOCRED and ENSERBIC. [↑](#footnote-ref-115)
116. The law 144 on the communitarian productive agricultural revolution already provides for the establishment of a guarantee fund for the sector and dedicated agricultural insurance products. [↑](#footnote-ref-116)
117. Banks had reportedly used leasing mostly to restructure their non-performing loans. [↑](#footnote-ref-117)
118. The findings on partial credit guarantees are largely based on a technical assistance provided on the topic by the World Bank in 2009 (see report from A Bozzo, 2009). [↑](#footnote-ref-118)
119. This does not hold for IFDs, which currently are not authorized to take deposits, and thus hinge for their growth on the available funding from donors, financial institutions and other sources. [↑](#footnote-ref-119)
120. It should be noted that there are some discrepancies with the data on average term structure of assets. Based on calculations from ASFI, the average asset in foreign subsidiaries, commercial banks and the public bank is less than one year, while the average maturity structure for microfinance institutions is slightly higher with around 1 year and 2 month. Average maturity terms did not change significantly over time, but showed a slight downward trend until 2009, and a potential trend reversal in 2010. [↑](#footnote-ref-120)
121. Article 330 on the financial sector. [↑](#footnote-ref-121)
122. The current banking law does not yet include the definition of a public bank, its status and peculiarities. This will be amended through the new banking law currently under preparation. *Banco Union* reports to the Treasury, as the latter is formally the main shareholder. There is no indication that the controlling ministry will change in the near future, but formalizing its status as a public bank will likely lead to the establishment of a formal public mandate of the bank as well as potentially changes in its governance structure. *Banco Union* is also subject to the full regulatory framework for financial entities, and is supervised by ASFI. [↑](#footnote-ref-122)
123. In combination with the possibility to use the annual profits for piloting those initiatives. [↑](#footnote-ref-123)
124. The Trust Fund to support the productive sector, *Fideicomiso para el Desarrollo Productivo* (FDP), for example offers credit to the productive sector, in particular tourism, for an annual interest rate of 6 percent. Targeting also micro-clients with a need for credit of around USD 10,000, these interest rates are significantly lower than the 16-18 percent charged in the private sector, while requiring similar levels of guarantees and offering similar maturities. The same holds for funds intermediated for FONDESIF (PACPUCS) and the Trust fund for Sesame (operated by BDP), which with an interest rate of 10 and 7-8 percent for loans up to roughly USD 1,000 and 40,000 significantly distort the market. [↑](#footnote-ref-124)
125. There are no mechanisms in place to determine a co-responsibility and share in carrying the financial loss for the participating financial institutions in the case of non-payment by the borrower. [↑](#footnote-ref-125)
126. The indicators should be aligned with the public mandate of fostering the development of the market, thus not be focused on adherence to financial soundness indicators. [↑](#footnote-ref-126)
127. Ideally using the categorization established by ASFI for this purpose. [↑](#footnote-ref-127)
128. The resolution No 693/11 from ASFI recently also introduced the requirement that financial institutions need to verify the tax declaration of SMEs for credit applications. This has the potential to significantly curtail the supply of credit to SMEs who are currently operating in the informal sector, and should come with a sufficient transition period to allow enterprises to become formalized. [↑](#footnote-ref-128)
129. See for example Rudolph (2010), “State Financial Institutions – can they be relied upon to kickstart lending?” World Bank Crisis Note No 12. Washington DC, or Smallville / Olloqui (2011), “A Health Diagnostic Tool for Public Development Banks”, IADB Institutions Capacity and Financial Sector Technical Capacity Notes, January 2011. [↑](#footnote-ref-129)