

Situating Micro-Finance on a Theoretical Spectrum: The Case of Bolivia

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According to the United Nations, 2005 was the year of micro-credit. Touted as “the newest darling of the aid community,” micro-credit has been promoted as a viable tool for development by influential international organizations such as the World Bank.¹ Despite a proliferation of literature on the benefits of micro-finance, few scholars have discussed the theoretical bases of this recent phenomenon. As such, this paper will argue that micro-finance can be theoretically situated on a continuum which is book ended by neo-liberalism and participatory development. The paper will then explore the parameters of three micro-finance institutions in Bolivia: Banco Solidario, Caja Los Andes, and ProMujer, and attempt to place them along this theoretical spectrum. In doing so, it will explore some of the disadvantages of the theoretical situations of each micro-lender, as they relate to the Bolivian market.

Theoretical Motivations for Microcredit

Micro-credit can be loosely defined as the provision of small loans to those who would not typically be able to borrow due to a lack of collateral.²

Micro-credit can be provided by a number of sources, including family

members, pawnshops, non-governmental organizations, and commercial banks.³ The formalization of micro-credit in recent years has been embraced by two theories of development: neo-liberalism and participatory development.

Neo-liberalism became a dominant theory of development in the 1980s, and continues to be the theoretical motivation for influential organizations such as the World Bank and the International Monetary Fund. Neo-liberal ideology relies on individuals to make rational decisions that are in their best interests, and assumes that such decisions will lead to the betterment of society through the growth of the market.⁴ This market should be as detached from the state as possible, with the state regulating rather than initiating economic activity.⁵ Economic growth and prosperity is the main goal of any development project, and “is considered of greater value than individual welfare, local culture and tradition, and the environment in development proposals.”⁶

Micro-credit does not initially appear as an area in which neo-liberals would be interested. As a ‘bottom-up’ method of poverty alleviation, micro-credit clashes with the typically ‘top-down’ methodology of neo-liberalism. However, micro-credit for micro-enterprise becomes

a neo-liberal construct when one views it as the formalizing an informal economy. According to a report on poverty reduction published by the World Bank, "Private enterprise operating through the market is the main engine of sustained economic growth."⁷ By exposing pre-existing informal economic networks, as well as providing the opportunity for the creation of additional formal businesses, neo-liberalism posits that the macroeconomic situation of the state will improve.

Whereas neo-liberalism is fundamentally about economics, participatory development (PD) is focused on power and community. In PD, economic power becomes a part of a holistic conception of power, which includes structures of knowledge, social situations, and political influences.⁸ PD values local diversity and agendas, seeking to implement projects using local knowledge, local capital, and local labour.⁹ The community is the agent that requires development, rather than the individual or the state. As such, PD is largely delivered by NGOs and community organizations rather than national or international bodies.¹⁰

The 'instrumental' strain of participatory development best explains the connection between PD and micro-credit. Within the instrumental view, "The goals of development are valid although the institutions are malfunctioning, but can be improved by involving the beneficiaries."¹¹ Micro-credit thus becomes a means of developing local communities according to a mainstream definition of development in an alternative way. By subverting the bureaucratic state, micro-credit allows the

true needs of individual communities to be addressed.

There are three primary grounds on which neo-liberalism and participatory development differ in terms of micro-finance. Firstly, neo-liberalism is focused on the betterment of the market, whereas participatory development is focused on the betterment of a community. Secondly, neo-liberalism relies of the rational choices of the individual, whereas participatory development relies on the collective choices of groups of and societies. Finally, given the neo-liberal bias toward economics, neo-liberals are more likely to view their borrowers as clients, whereas those valuing participatory development consider their borrowers as beneficiaries.

With this theoretical spectrum in mind, it is pertinent to examine several cases of micro-lending institutions, their compositions, their 'clients' and their services. In doing so, the theoretical applications of both neo-liberalism and participatory development will become more apparent, as will the ambiguous middle ground in between these polarized ideologies.

Micro-Finance in Bolivia

Bolivia is currently home to a wide variety of micro-lending institutions. The Bolivian market was primed for such institutions throughout the 1980s, when dense urban populations and the effective failure of the formal financial sector caused extreme poverty and disillusionment with traditional banking.¹²

Conning et al. (2003) divide the evolution of the Bolivian market for micro-credit into three stages. The first stage

began in 1992 with the emergence of commercial bank Banco Solidario (BancoSol). The second stage began three years later, when financial intermediary (*Fondo Financiero Privado*, henceforth referred to as FFP) Caja Los Andes entered the regulated market, providing substantial competition for BancoSol. The third stage, beginning around 1998 and continuing into the present, has been characterized by a dramatic increase in competition. Smaller micro-lenders have flooded the market, including innumerable unregulated NGOs targeting specific populations. In July 2003, 220 regulated organizations existed to provide micro-credit, compared with the monopoly held by Banco Solidario nine years earlier.

Based on this evaluation, it is clear that Bolivia is an excellent market in which to examine different varieties of micro-lenders. Three organizations have been chosen, each characterizing one of Navajas et al.'s stages of micro-credit in Bolivia: Banco Solidario, Caja Los Andes, and ProMujer.

Stage I: Banco Solidario

Infrastructure

Banco Solidario (BancoSol) was formed from the NGO *Fundación para la Promoción y Desarrollo de la MicroEmpresa* (PRODEM, est.1987) in 1992, and was the first NGO to evolve into a commercial bank.¹³ An understanding of the implications of the title "commercial bank" to micro-finance is critical to understanding the foundations of BancoSol.

As a commercial bank, BancoSol has been able to expand its services to include debit cards, tax payments, mortgages, and loans to finance the purchases of vehicles.¹⁴ In addition to this expansion of services, the status of commercial bank has allowed BancoSol to attract more foreign and national private capital.¹⁵ This capital has increased the cost of liabilities, forcing BancoSol to improve its efficiency through projects such as more advanced computing systems. More experienced and business-minded managers were hired to supervise and implement this costly process. In order to minimize the financial impact of a more advanced infrastructure, BancoSol provided longer and larger loans, resulting in an increase in clientele from 23,000 in 1992 to 81,000 in 1998.¹⁶

The benefits of commercial bank status have been accompanied by tight regulation by the government, including stipulations regarding eligibility for a loan, hours of operation, and interest rates.¹⁷ As such, BancoSol has encountered both advantages and disadvantages in the status of commercial bank.

Clientèle

In 2002, BancoSol provided loans to 50,904 clients, and an average loan of \$827 in 2001.¹⁸ Their poorest client in 1999 received an annual salary of \$60.¹⁹ Comparatively, BancoSol's clients are neither extremely wealthy, nor extremely poor. As the largest micro-lending institution in Bolivia, BancoSol is unable to offer specified loans and therefore appeals more to the status quo than any minority. This "one size fits all" philosophy can hinder both higher-productivity borrowers and those who need special accommodations to escape severe poverty.²⁰ By providing a series of standard loans, BancoSol is able to reach the

broadest market possible, at a lower overall cost.²¹

Loan Structure

BancoSol has traditionally provided group loans at a minimum of \$100.²² These groups consist of three to seven people who own a variety of businesses, each of which must be at least six months old. Within a group, there must be some similarities in terms of credit needs, and the businesses must not be related in terms of transactions or family connections. Group members are individually assessed for their abilities to repay based on interviews, personal financial information, and business records.²³

Once a group has been formed, it is accountable for collective installments to repay the bank. This form of “social collateral” ensures that if one group member is unable to pay, the rest of the members must compensate for the deficit.²⁴ Should the group installment be incomplete, pressure will be placed on the entire group through financial penalties and threats of reporting group members as defaulters to other credit agencies. Once a group has repaid the initial loan, it is eligible for a second, larger loan. This progressive lending attempts to ensure customer loyalty.²⁵

Stage II: Caja Los Andes

Infrastructure

Caja Los Andes was established in 1995, emerging from the NGO Procredito (est. 1992). As of July 2003 Caja Los Andes was one of seven FFPs in Bolivia, and one of the most profitable micro-finance agencies in Bolivia.²⁶ The legal category of FFP was established in 1993 to designate financial institutions that are solely devoted to micro-finance. In order to obtain the status of an FFP, the micro-finance operation

must be run by those experienced in the provision of micro-credit.²⁷ An FFP is regulated in similar ways to a bank, with the main distinction being much lower minimum capital requirement.²⁸ However, unlike banks, FFPs cannot provide specific services such as chequing accounts or trust funds.

Clientèle

Caja Los Andes serves primarily urban clients. Clients are generally better educated, wealthier, and better established than those of BancoSol. Whereas 3 percent of BancoSol clients had achieved beyond a grade 12 education in 1995, 11 percent of Caja Los Andes clients had achieved this level. Clients of Caja Los Andes are more likely than those of BancoSol to have access to running water, electricity, and waste disposal services within their home. They are also more likely to own their homes, and possess liquid collateral.²⁹

Loan Structure

Similar criteria are held for loan eligibility, including a clean credit history and a business that has been in operation for at least a year.³⁰ However, the types of loans that are offered vary significantly with those of BancoSol. Caja Los Andes offers only individual loans, often secured through personal guarantees. Loans are often larger, with an emphasis on financing manufacturing projects. In 1995, eight percent of Caja Los Andes loans were over \$1000, whereas zero percent of BancoSol loans exceeded the same amount. In terms of all loans offered by both institutions, 27 percent of Caja Los Andes's were over \$1000, compared to 18 percent of BancoSol's.³¹

Screening processes are also more extensive and precise. A critical component of the screening process allows Caja Los Andes to “tailor loan contracts to each

borrower's productivity level."³² Caja Los Andes is also careful to offer loans only to borrowers "to which it can profitably lend."³³ This specification of economic potential has allowed Caja Los Andes to reduce interest rates and become a more efficient operation. However, this has also meant a decreased interest in providing smaller loans, as they are less profitable.

Stage III: ProMujer

Infrastructure

ProMujer is a micro-finance institution that lends solely to women. It began in 1990, as an NGO that provided training for women on familial and domestic issues. Services expanded the following year to include micro-credit, although this service did not become remarkably popular until 1994.³⁴

As an NGO, ProMujer experiences the least regulation of all micro-lenders examined in this paper.³⁵ As such, the composition of ProMujer is not determined by the government. Between 81 and 90 percent of ProMujer's operations are concerned with micro-finance, and the remainder seek to educate women on everything from childcare to business management.³⁶ The mission of ProMujer is, "is to empower women to improve their social and economic status... Since good health and self-esteem directly contribute to a woman's ability to earn income and care for her family ProMujer also provides health and human development and links women and their families to health services."³⁷ (ProMujer, 2005) ProMujer is focused on creating links between women and other women, and between women and their communities as a way to attain development.

Clientèle

ProMujer's clientèle is much more specific than that of either Caja Los Andes or BancoSol. ProMujer lends to primarily urban women, most of whom have recently migrated from surrounding urban areas. This specific form of loan has caught on - between 1994 and 2003, ProMujer's client base grew from 4,000 to nearly 40,000. The average loan size is a mere \$146, with a minimum loan of \$50, indicating that borrowers are operating smaller businesses with lower capital needs.³⁸ ProMujer's clients are generally poorer than those of other micro-credit agencies, with the poorest clients earning \$45 annually. According to an analysis conducted by Marconi et al., 38.3 percent of the clients of ProMujer and similar NGO Crecer were "poor and destitute," as opposed to 10.6 percent of clients of other micro-finance institutions.³⁹ In the same way, 14.1 percent of ProMujer and Crecer clients did not have the lowest level of education, as opposed to 5.1 percent of other micro-finance clients.⁴⁰

Loan Structure

ProMujer provides the most comprehensive and time-intensive form of micro-credit. As previously discussed, ProMujer emphasizes training as a vital counterpart to the actual loans offered through micro-credit. This emphasis is actualized in ProMujer's three-part credit program, which includes 16 hours of pre-credit training, and a four-month initial loan period in which weekly meetings are held to continue training. During the pre-credit program, women form "solidarity groups" similar to those formed by clients of BancoSol. These groups are then responsible for the repayment of a group loan, and the amount offered for a loan can increase with successful repayment. Unlike BancoSol, ProMujer stresses the community aspect of these groups, ensuring that the women are able to

connect on levels transcending the financial. Larger groups of 25 to 30 women form communal banks to supervise these solidarity groups.⁴¹ Another way in which community is emphasized is through the mandatory saving of 10 percent of the loan value. This is set aside as an emergency fund, which can be accessed by any member of a solidarity group in dire circumstances.⁴²

Theory: Applications & Inadequacies

Caja Los Andes is evidently the most neo-liberal micro-credit institution examined. Its emphasis on economic efficiency, the rational individual as a borrower, and its status as one of the most profitable micro-lenders are consistent with neo-liberal principles. However, Caja Los Andes is not providing micro-credit to the poorest of the poor, a value of micro-credit that was specified in a summit on micro-credit held in 1997.⁴³ This exposes a weakness in neo-liberal theory. If the market is to be the driving force behind the development of micro-finance, then increased competition, such as is witnessed in Bolivia, will prompt micro-creditors to seek more affluent borrowers in an attempt to receive a greater return on loans.⁴⁴ This alienates the poorer sector of society, and caters only to the development of the elite. However, this is still consistent with neo-liberal theory. In fact, a natural progression to the 'top' of society would complement neo-liberal theory, which often operates as a top-down model. Perhaps neo-liberalism is not as suited to the brand of micro-finance it supports in rhetoric; if the neo-liberal model followed closely, it avoids development at lower levels of income.

ProMujer, sits on the opposite end of the continuum, conforming to the theory of participatory development. This is theoretical foundation is demonstrated within ProMujer's credit program, where loans promote collective progress through

local communal banks and mandatory savings. However, this body of theory has also encountered criticisms. The mandatory training accompanying loans has been labeled by some borrowers as unnecessary – even patronizing – consuming valuable time that could be used to develop their businesses.⁴⁵ This is particularly a problem with women, who are often trying to manage their businesses at the same time as their households. Secondly, by refusing to move to higher-profit borrowers like Caja Los Andes, ProMujer is relying on poverty to sustain its well being. As stated by Elahi, "the potential consequence of the establishment of micro-finance industry in the Third World is the creation of private groups that might have vested interests in the perpetuation of poverty."⁴⁶ The conflicts of condescending training and an unnatural reliance on poverty restrict the further growth of NGOs such as ProMujer.

Finally, BancoSol is theoretically mixed. Its group lending technique is characteristic of participatory development, but its drive for status as a commercial bank was largely motivated by neo-liberal ideals. BancoSol is most distinctly neo-liberal in its treatment of borrowers as clients, rather than beneficiaries. The large size of BancoSol does not allow for charity or exception, and thus, borrowers are confronted with a variety of generic loans that may or may not suit their needs. This "blurring of banking and social development discourse," has alienated borrowers, as they are often expecting to be treated as beneficiaries, and are surprised when they are treated as clients.⁴⁷ The rift between BancoSol and its borrowers became a problem during the Bolivian economic crisis of 1999, when indebtedness skyrocketed, and BancoSol's return on equity fell from 29 percent to 9 percent.⁴⁸ By attempting to straddle both theories while new micro-lenders target

specific demographics, BancoSol is losing its ability to appeal to the general public.

Conclusions

It is clear that micro-credit can be theoretically motivated along a spectrum wherein neo-liberalism is at one extreme and participatory development at the other. This has been exemplified by three micro-financiers from the Bolivian market: BancoSol, which is theoretically mixed, Caja Los Andes, which is primarily neo-liberal, and ProMujer, which is primarily influenced by participatory development. Many complexities exist within this

framework, which have been highlighted as the Bolivian market has become saturated with micro-lenders. We have seen that neo-liberalism can ignore the poor, participatory development can inhibit innovation and could preserve poverty, and a hybrid of both theories can stagnate and alienate borrowers. Regardless of which theory is employed to create a lending institution, micro-finance continues to be a compelling force in development. Situating micro-finance theoretically can help to us understand why it has become so diverse and disjointed.

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