

MULTILATERAL INVESTMENT FUND PROJECT ABSTRACT

BOLIVIA

I. BASIC PROJECT DATA

Project Name: Increasing the supply of financing to rural productive activities
Project Number: BO-M1011
Country: Bolivia
Project Team: Valentina Sequi, team leader (MIF/INV); Edgar Rivera (MIF/INV), Tomas Miller (MIF/INV), Fernando Catalano (COF/CBO), pending (LEG).
Date of Request: September 2005
Beneficiaries: Bolivian rural microenterprises
Executing Agency: Fundacion Agrocapital (Agrocapital)
Financing Plan: MIF Line of Credit (IIIB) US\$2,000,000

MIF Technical Assistance (IIIA) US\$ 140,000
Agrocapital US\$ 70,000
Total US\$2,210,000
Tentative dates: CESI: October 2005
Donors: December 2005
MIF Classification: SMF/MCRO

II. BACKGROUND AND PROBLEM STATEMENT

A. Background and Problem Statement

- 2.1 The microfinance industry in Bolivia is one of the most developed in LAC and microfinance activities account for a quite significant 22% of the financial system. After a difficult period during 1998-2001 when many institutions were forced to write off a large number of bad loans, most recently the microfinance industry has performed well in terms of portfolio growth, quality and profitability.
- 2.2 In spite of the industry's maturity and dynamism, a number of challenges remain. Particularly important is the gap between the availability of financial services in rural areas compared to urban areas. The high costs and added riskiness of serving rural clients have discouraged most microfinance institutions from attending those markets, resulting in an undersupply of financial services. With the exception of Fondo Financiero Privado Prodem (FFP Prodem), there is no major microfinance institution with significant presence in the rural area. As for the NGOs that do serve the rural areas, they have limited coverage and small portfolios. As an illustration, of the 234 agencies belonging to the Bolivian Association of Financial Entities Specialized in Microfinance (ASOFIN), only 78 are in rural areas, and of those, 51 are FFP Prodem agencies.

- 2.3 Another important challenge facing the industry is to redress the imbalance in the provision of financing to productive activities compared to commercial activities. Productive activities can have a multiplier effect on a country's economy by increasing demand for the raw materials and other inputs to the production process as well as through their heavy reliance on labor and associated services. As of March 2005, however, only 21% of the portfolios of ASOFIN members were in productive activities. The productive sector is less attractive to microfinance institutions because it requires specialized credit methodologies and tailored loan products – a learning curve that most institutions have not been willing to climb, especially because of the plentiful demand for credit by commercially focused microenterprises. Furthermore, productive activities tend to be more risky since they are more prone to external shocks (e.g., drought, commodity price changes) and less able to adapt to changing business conditions.

B. Program Rationale

- 2.4 This project seeks to provide a line of credit, as well as a technical assistance grant to support one of the few microfinance institutions that distinguishes itself by its focus on the rural productive sector in Bolivia. Indeed, in 2004, 37% of Agrocapital's approved loans went to the productive segment, a significantly higher proportion than the 21% of the ASOFIN portfolio in productive activities.
- 2.5 The main obstacle that is currently limiting the growth of Agrocapital is the lack of funds for on-lending since its NGO status prohibits it from taking client deposits. Indeed, Agrocapital is in the process of seeking authorization from the SBEF to constitute a regulated Fondo Financiero Privado (FFP) under which to transfer its credit operations¹. This is positive not only because it will grant Agrocapital well-deserved recognition of its financial strength, but more importantly, it will authorize Agrocapital to raise funds through deposits.
- 2.6 The MIF's support will help the institution transition from a foundation to an FFP through careful scaling up of its activities and by putting in place the right foundation on which to operate a large regulated institution. The technical assistance will focus on strengthening the institution's corporate governance practices in order to redress the shortcomings of the governance system that was set up when the foundation was constituted in 1992 and, replace it with a robust oversight mechanism in line with the additional responsibilities of FFP status. A small component of technical assistance will also be included to help develop and implement coherent policies and systems for collaboration between the FFP and the Foundation once the two organizations are split.
- 2.8 The MIF's participation in the project is consistent with its mission of deepening rural financial systems, and expanding access to financial services to micro and small enterprises. The MIF's loan to Agrocapital will not crowd out local deposits, which are expected to grow in line with the growth of the loan portfolio.

¹ A *Fondo Financiero Privado* is a type of regulated entity with lower capital requirements than traditional banks. Most regulated microfinance institutions in Bolivia have converted to FFP status and almost all FFPs in Bolivia focus on microfinance activities.

This operation is particularly interesting because of the opportunity to demonstrate on a large scale the viability of lending to the rural productive sector.

III. PROGRAM OBJECTIVES AND DESCRIPTION

A. Objectives

- 3.1 The goal of this project is to achieve, via demonstration effects, a deepening in the total provision of financial services especially targeted at the productive sectors of the economy in rural and peri-urban areas of Bolivia. This process will improve the access of lower-income households to financial services, and indirectly improve their incomes and the overall competitiveness of the rural economy.
- 3.2 The specific objective is to support the expansion of Agrocapital's lending activity in the productive sector of the rural economy by implementing the following two components: (i) a line of credit for on lending to rural productive activities; and (ii) a technical assistance for strengthening Agrocapital FFP's governance system ensuring that it complies with the new responsibilities of being a regulated institution as well as its new responsibilities as main shareholder of the FFP.

B. Description

- 3.3 The project will include the following two components:

Component I. *Line of Credit.* The MIF will provide a USD\$2.0 million line of credit at market interest rates. The overall availability of the line of credit will be six years but will be renewable in two-year tranches based on successful implementation of the technical assistance components. This financing will enable Agrocapital to make approximately 1,000 new loans at an average loan size of \$2000. The loan will be conditioned on the institution maintaining a minimum ratio of productive sector loans to total portfolio. This ratio will be defined during the detailed due diligence phase.

Component II. *Technical assistance grant to improve Agrocapital's corporate governance and develop a transition plan for setting up an effective governance mechanism for the FFP.* Issues to be addressed include: preparation of a "Code of Good Governance" establishing the structure and functioning mechanisms of the oversight entities; definition of criteria for board member selection, board member responsibilities and mechanisms for replacement; definition of role of management on Board; and, preparation of tools and formats for information dissemination to board and for tracking institutional performance. In addition, the technical assistance grant will be used to analyze and define a new model for how the FFP and the Foundation will work together in an "arms length" way (e.g., in addition to the governance issues, the consultancy will help establish operating guidelines and define whether the FFP and the Foundation can partner in other areas such as business services.

III. COST AND FINANCING

- 4.1 The total cost of the project and its structure is estimated to be \$2,210,000. The MIF contribution, divided into two components, includes a \$2,000,000 loan and \$140,000 technical assistance grant, of which \$30,000 will be administered from headquarters and will be used to finance evaluations, legal fees and supervision of the line of credit. Counterpart funds of \$70,000 will be provided by Agrocapital.

V. EXECUTING AGENCY AND EXECUTION STRUCTURE

- 5.1 The Agrocapital foundation is a private, non-profit organization that was created in 1992 with the mission of contributing to the development of Bolivia's rural and peri-urban areas. The institution's founding capital was provided by funds obtained through the sale of USAID food program in-kind donations. After several years of legal disputes over the ownership of those funds, in March of 2004, the Bolivian Interior Ministry officially informed the Superintendency of Banks (SBEF) that Agrocapital had legitimate ownership of its equity base. This decision has opened the way for Agrocapital to seek authorization from the SBEF to constitute the FFP, transfer the foundation's existing credit portfolio and become majority shareholder of the FFP.
- 5.3 The original mission of Agrocapital was to support farmers substituting coca crops with other crops in areas around Cochabamba and Santa Cruz. Over time, the institution's reach spread to other rural areas distinct from the coca producing ones. Today, Agrocapital has 11 branches clustered around the cities of Santa Cruz, Cochabamba and La Paz. Approximately 77.1% of Agrocapital's portfolio is located around Santa Cruz, another 19.9% around Cochabamba and the remaining 3% is in the El Alto area. The FFP will occupy the foundation's existing branches. (Please see Annex 1 for basic characteristics of rural branches)
- 5.4 Although Agrocapital's focus is on productive enterprises mostly in the agriculture and agro-industrial segments, it also targets commercial, transport and service activities that are linked to and complement the local agriculture sector. This balance ensures a properly diversified portfolio.
- 5.5 Agrocapital offers two main types of financial products:
- The *Microcredit* line is used to finance both working capital and investment projects for microbusinesses. The minimum loan size is \$100 and the average loan size is \$1,887 with a maximum term of 3 years. The interest rate is based on market rates and typically fluctuates between 18% and 30%.
 - The *Investments* line is oriented to financing small rural and urban businesses that need financing for fixed capital improvements and/or working capital at longer terms and higher amounts than the Microcredit portfolio, most of which are in the agriculture and agro-industrial segments. The bulk of the loans for productive enterprises fall within the Investment line. The average

Investment loan size is \$16,500, terms are capped at 5 years for capital improvement loans and 3 years for working capital loans, and interest rates fluctuate between 13% and 20%. It is important to note that Agrocapital intends to slowly reduce the proportion of Investment loans within the overall portfolio as the institution converts to FFP status and grows². Although this will move the FFP somewhat away from its traditional focus, the rationale behind this change is prudent and is based on the institution's need to hedge the higher-risk Investment portfolio. While the weight of the Investment portfolio within Agrocapital's activities will decrease, overall, the size of the Investment portfolio is expected to increase by 150% in 5 years.

- 5.8 Agrocapital's overall financial indicators illustrate a healthy institution although one that is somewhat affected by the higher risk segments of its portfolio (Please see Annex II for Financial Indicators). As of the end of 2004, Agrocapital had a bad debt ratio of 6.4% (one day past due). It is important to note, however, that there is substantial difference between the two product lines: the Investment line had a arrears of 9.4%, but the Microcredit line had much lower arrears of 2.7%.
- 5.9 In the past, the Agrocapital Foundation has received several rounds of financing from international organizations as well as Bolivian second tier lenders, including the IDB, CAF, OIKOCREDIT, FONDESIF, and FUNDAPRO³. Until Agrocapital becomes a deposit-taking institution, external credit will be vital to ensure that it will have funds to onlend and indeed, the MIF regularly lends to non-regulated entities side-by-side with other national and international lenders. The foundation will be the largest shareholder in the new FFP but the FFP will have private investors as well. The FFP's equity base will initially be US\$2.5 million and is projected to increase over the first five years of operation to US\$5.0 million. Throughout, the Debt to Equity ratio is expected to remain below 7, an acceptable level for a microfinance institution.

VI. MAJOR ISSUES

- 6.1 The key issues to address during the analysis of the project, are: (i) to assess the potential obstacles and likely timing of conversion to FFP; (ii) determine the feasibility of the high expected growth rate and assess the institution's ability to grow so quickly maintaining a quality portfolio; (iii) assess the level of competition from other MFIs and its impact on the institution's ability to meet growth projections as well as the potential downward pressure on interest rates.

VII. ENVIRONMENT AND SOCIAL ISSUES

- 7.1 Agrocapital will be required to comply with the IDB/MIF environmental and social guidelines for MIF transactions with financial intermediaries as well as with local environmental guidelines.

² Nevertheless, Agrocapital's projections are that by Year 5 after the launching of the FFP, a still significant 42% of the portfolio will be Investment loans, which represents a relatively small reduction from its level today.

³ Today, the foundation has obligations of US\$6.6 million with these institutions