

FINANCING UNDER THE MULTILATERAL INVESTMENT FUND

BOLIVIA

BANCO DEPARTAMENTAL DE LOS ANDES (PRO-CREDITO)

(TC-93-07-42-3)

EXECUTIVE SUMMARY

- BORROWER:** Banco Departamental de los Andes y Asociación PRO-CREDITO. The bank is the successor of an association known as PRO-CREDITO, a rapidly growing nongovernmental association specializing in lending to microenterprises that converted to a formal financial institution classified as a "departmental bank" or the equivalent under Bolivian banking legislation. PRO-CREDITO and two private Bolivian shareholders hold a majority of the capital. Capital contributions have also been made by the Andean Development Corporation (CAF) and Swiss Technical Cooperation (STC).
- AMOUNT AND SOURCE:** The total project amount is US\$2 million, to be financed with a loan of US\$1.4 million, an equity investment of US\$400,000, and nonreimbursable technical-cooperation funding of US\$200,000. The funds will be drawn on Facility III-B of the Multilateral Investment Fund (MIF), the Small Enterprise Investment Fund (SEIF), and the technical-cooperation funding will be drawn on facility III.A from the same fund.
- TERMS AND CONDITIONS:**
- A. Loan: The prospective loan will be denominated in U.S. dollars, with a proposed term of eight years, a four-year grace period, repayments in equal semi-annual installments, and an interest rate equivalent to (i) the development credit auction rate set by the Central Bank of Bolivia, or (ii) the average rate paid on time deposits by Bolivia's major financial institutions, whichever is higher.
- B. Equity investment: (i) Subscription: The MIF will subscribe ordinary shares, at no time to exceed 25% of the total capital stock of Banco Departamental de los Andes, at an aggregate price of up to US\$400,000 equivalent. (ii) Representation on the board of directors: Subscription will give the MIF the right to appoint a member of the board of directors. (iii) Payment of dividends: The institution's long-term goal is established in its bylaws through

the decision to capitalize 100% of net profits generated in order to increase its capital endowment and underwrite its growth. (iv) Sale of shares: The MIF may sell all or part of its shares starting at the end of the fifth year following the payment of capital, giving preference to the founding stockholders, at a price per share satisfactory to the MIF; (v) Put option: The MIF will have the option to sell its shares to the association PRO-CREDITO as from the fifth year and no later than the eighth year following the payment of capital. The price per share, should that option be exercised, will be 1.3 times book value.

C. Nonreimbursable technical-cooperation funding: this will be provided as a grant for the purpose of contributing to the institutional strengthening of the entity during its transformation into a regulated financial institution.

OBJECTIVES:

The objective of the proposed financing is to expand the capital structure of Banco Departamental de los Andes in order to enhance its ability to offer financial services to small businesses and micro-enterprises using specialized financial technology.

DESCRIPTION:

The MIF financing would be used to support the development of a private bank and thus help to create a financial system capable of meeting the needs of the private sector, especially the microenterprise sector. Through this operation, the MIF would give greater support to a larger number of small businesses than it could give directly. In addition, the loan will help to augment the country's volume of capital investment, which will in turn make it possible to update the technology for industrial equipment and raise incomes in the sectors most affected by the economic adjustment process.

**JUSTIFICATION FOR
USE OF MIF FUNDS:**

The MIF's participation in this operation will be instrumental in supporting an NGO with a successful microenterprise credit program as it enters the formal financial system. The MIF contribution will make it possible to expand the new bank's capital base, which will enhance its ability to raise the resources necessary to realize the substantial growth projected in its financial services for small businesses and microenterprises.

**ENVIRONMENTAL
CLASSIFICATION:**

The Environmental Management Committee, at its meeting CMA 42/93 of October 26, 1993, classified this as a Category II operation.

RISKS:

The risk analysis covered both risks not specifically tied to banking, such as a worsening of political and economic conditions, lack of demand and wage increases, and specific risks to the banking system, such as uncollectability and withdrawal of deposits. The analysis shows that even in an extremely negative scenario Banco Departamental would cover its costs and would make a profit in the second year of operation.

**PROJECT
ELIGIBILITY:**

The project meets all the requirements governing eligibility for SEIF financing. It would significantly further the growth of private investment, foster microenterprise activities and strengthen the participation of small businesses in the Bolivia economy. It is also consistent with Bank strategy in Bolivia as set out in the country programming paper.

I. COUNTRY ELIGIBILITY

- 1.1 Bolivia's eligibility for funding under the Multilateral Investment Fund (MIF) was approved by the Donors Committee at its October 6, 1993, meeting, based on the country eligibility memorandum approved by the Bank's Programming Committee on September 22, 1993.

II. BACKGROUND

- 2.1 After the structural economic crisis seen in Bolivia until 1985, when all the economic indicators worsened and the resulting hyperinflation spiraled to more than 8,000% per year, with negative growth in GDP, the economy slowly began to recover in 1987. The groundwork for this recovery was laid by the administration that took office in 1985, in close collaboration with the multilateral cooperation organizations. Those policies were continued by the new government that took office in August 1989.
- 2.2 Among the major measures taken under this recovery program were the liberalization of prices in the various markets, a tax reform, public spending cuts and the privatization of state enterprises, as well as efforts to resolve the external debt problem. The application of this economic policy brought about a gradual improvement in economic indicators, with a real per capita increase in GDP of 1% yearly from 1987 to 1991. However, this level of growth was not sufficient to offset the setbacks of the first half of the 1980s. This is evidenced by, firstly, the fact that the economic structure has changed little, with agriculture remaining its mainstay, and, secondly, the country's continuing strained social situation.
- 2.3 Bolivia's economic structure is still far from robust. The domestic market is small, with extremely heterogeneous demand. Industrialization is limited, with exports hobbled by the high transport costs rooted in the country's geographic situation and structure. The persistent stream of migration from the countryside to the cities has swelled the ranks of the informal sector, which, with an 11.4% share of GDP, is in fact one of the economy's most important sectors. Its importance is even greater in terms of job creation, with a 58% share of urban employment (see Annex I).
- 2.4 Undoubtedly the economic policy of the last few years has achieved its best results in the monetary sphere, lowering inflation to 10% per year, a notably low rate in comparison with other Latin American countries, and bringing stability to central bank reserves, which stand at approximately US\$300 million.

- 2.5 One of the major unresolved obstacles to economic growth stems from high interest rates, which clearly discourage investment. In December 1992, average lending rates stood at close to 19% per annum for dollar loans, more than 10 percentage points above the international level. Meanwhile, the policy and operational characteristics of the banking system deny access to financial services to large sectors of the economy. This is reflected in the fact that close to 72% of the banking system's lending volume is concentrated in approximately 3,500 loan agreements, with more than two thirds of all deposits being made by only 4% of all depositors (see Annex II).
- 2.6 This very limited coverage of the formal financial system has, as in other Latin American countries, given rise to the presence of various operators in the informal financial sector, such as financiers, traders, lenders and others, who are not subject to control and oversight by the system's regulatory agencies. Another noteworthy feature of this system is the proliferation of lending programs and activities developed by nonspecialized entities. These are nongovernmental organizations which have generally added credit as a component accessory to their social promotion programs.
- 2.7 The Government of Bolivia has carried out substantial reforms in the financial sector in order to open up new opportunities for private capital by raising the volume and efficiency of domestic and foreign investment. The Program to Reform the Financial Sector and Promote Private Investment of the Bank has improved the banking system's competitive environment by widening the range of borrowers and savers, abolishing interest rate controls, improving the legal and supervisory framework of the banking and financial system, and eliminating obstacles to the development of capital markets. One of the results of this program is that new formal intermediary institutions, called *bancos departamentales*, or departmental banks, can now do business under the new law on banks and financial organizations enacted in April 1993. These banks are authorized to offer a full range of financial services within a particular department, except those relating to external trade. They have a minimum capital requirement of 360,000 special drawing rights (equivalent to approximately US\$580,000).
- 2.8 Against this background, the association PRO-CREDITO, a nongovernmental organization, was founded in 1991 with the aim of providing lending services designed for microenterprises and small businesses. These services burgeoned, and the organization sought entry to the regulated system in order to continue to expand its financial services and obtain access to resources within the formal financial system. It thus embarked on its course of transformation into a departmental bank. To that end, contact was made with several international cooperation agencies interested in supporting the Bolivian government's efforts at reform and democratization of the financial system. At present, steps are being taken to obtain approval for the founding of this bank from the Bank Examiner's

Office, on the part of PRO-CREDITO, private shareholders and two of its founding members, STC and CAF.

III. THE BORROWER

- 3.1 Unlike other NGOs, PRO-CREDITO had the creation of a regulated financial institution as its main objective from its inception. It was in this context that in June 1992 it expressed interest in gaining access to funds under the MIF's Small Enterprise Investment Fund (SEIF). As a result of the founding last August 13 of Banco Departamental de los Andes, in which PRO-CREDITO has a majority interest, PRO-CREDITO has ceased to offer lending services as of the start of its operations. The boards of directors of PRO-CREDITO and Banco Departamental therefore decided to submit this loan request under the name of Banco Departamental de los Andes.
- 3.2 The objective of Banco Departamental de los Andes is to bring about efficient financial intermediation by facilitating the integration of socially and economically disadvantaged sectors into the formal financial system. In the context of this institutional objective, mention should be made of the long-term goal expressed in the stockholders' decision to capitalize 100% of net profits in order to broaden its capital base and further its growth.
- 3.3 Subscribed and paid-in capital is US\$1 million, made up as follows: PRO-CREDITO owns 60% as body corporate, plus 10% through two of its founding members (whose curricula vitae are included in Annex III); CAF owns 20% through funds from the Gesellschaft für Technische Zusammenarbeit (GTZ); STC owns 10%. Annex III includes a brief description of the stockholders. The two individuals who own shares in the new bank have an outstanding record in promoting microenterprise activities and have shown a high degree of commitment to providing support to disadvantaged population groups. Shares would be available for acquisition by other shareholders who share Banco Departamental de los Andes' operating philosophy, vocation and dedication to serving the sector.
- 3.4 Bolivian banking legislation establishes a 20% limit on votes for all stockholders, regardless of their equity interest. This provision is intended to harmonize domestic and international interests in decision-making.
- 3.5 During the first two years, Banco Departamental de los Andes will offer the following services: (a) credit for microenterprises and small businesses; (b) loans to the general public secured by gold as collateral; and (c) savings and time deposits services. During this period, the Bank will operate in the cities of La Paz and El Alto, as well as some rural areas of the department.

- 3.6 The financial economic analysis conducted to meet the requirements of the Bank Examiner, based on conservative assumptions, indicates a high degree of prudence with little sensitivity to risks, so that the bank's development can be expected to be sound in the years ahead.

IV. THE PROJECT

A. Project components

- 4.1 This project involves a request for US\$2 million, of which US\$1.4 million are being requested in the form of a loan, US\$400,000 as an equity investment in the capital stock of Banco Departamental de los Andes (or its successor company), and US\$200,000 as nonreimbursable technical-cooperation funding. The objective of the proposed financing is to expand the capital structure of Banco Departamental de los Andes in order to enhance its ability to offer financial services to small businesses and microenterprises using specialized financial technology.
- 4.2 The equity investment is less than that initially proposed, to maintain the balance between domestic and international stockholders. The impact of this share increase, which includes an increase in shares held domestically, is reflected in the following table:

Impact of the prospective equity investment by the MIF

Current status

| | Bolivian shareholders | | | International shareholders | | | |
|-------------------------------------|-----------------------|--------------|-----------------|----------------------------|---------------|--------------|-----------------|
| | Amount (US\$) | % of capital | Number of votes | | Amount (US\$) | % of capital | Number of votes |
| PRO-CREDITO | 600,000 | 60% | 20 | STC | 100,000 | 10% | 10 |
| F. RÜCK | 50,000 | 5% | 5 | CAF | 200,000 | 20% | 20 |
| J. CRESPO | 50,000 | 5% | 5 | MIF | 0 | 0% | 0 |
| Total | 700,000 | 70% | 30 | Total | 300,000 | 30% | 30 |
| Total equity capital: US\$1,000,000 | | | | | | | |

Status with MIF interest

| | Bolivian shareholders | | | International shareholders | | | |
|-------------------------------------|-----------------------|--------------|-----------------|----------------------------|---------------|--------------|-----------------|
| | Amount (US\$) | % of capital | Number of votes | | Amount (US\$) | % of capital | Number of votes |
| PRO-CREDITO | 600,000 | 37.5% | 20 | STC | 100,000 | 6.2% | 6 |
| F. RÜCK | 150,000 | 9.4% | 9 | CAF | 200,000 | 12.5% | 12 |
| J. CRESPO | 150,000 | 9.4% | 9 | MIF | 400,000 | 25.0% | 20 |
| Total | 900,000 | 56.3% | 38 | Total | 700,000 | 43.7% | 30 |
| Total equity capital: US\$1,600,000 | | | | | | | |

4.3 The MIF's participation in this operation will be instrumental in supporting an NGO with a successful microenterprise lending program as it enters the formal financial system. The MIF contribution will make it possible to expand the new bank's capital base to improve its ability to raise the resources necessary to realize the substantial growth projected in its financial services for small businesses and microenterprises. By the same token, the MIF loan would support the development of a banking institution, thus contributing to the creation of a financial system that is more competitive and capable of meeting the needs of the private sector, especially the microenterprise sector. In addition, the loan will help to augment the country's volume of capital investment, which will in turn make it possible to update technology for industrial equipment and raise incomes in the sectors most affected by the economic adjustment process.

4.4 The nonreimbursable technical-cooperation funding will be used to streamline the banking institution's financial and operating practices by changing its institutional structure so that it can better serve the customer base targeted, and be integrated more easily into the formal system. The resources will also be used to help the Asociación PRO-CREDITO develop innovative financial systems, including studies and pilot projects for new products for

microenterprise, such as guarantees, leasing, mortgage, insurance, etc.

B. Project execution

- 4.5 In terms of infrastructure and human resources for the execution of the project, Banco Departamental de los Andes can rely on back-stopping by PRO-CREDITO at the outset of its endeavors. This would come about through the transfer of PRO-CREDITO's present facilities, consisting of a head office in La Paz and four branch offices: two in La Paz and two in El Alto. This decentralization of operations will prove a convenience to customers, as they will have less far to go to obtain credit and to repay loans. The new bank will also be supported by GTZ experts on long-term contracts who will assist in transforming PRO-CREDITO into a formal financial institution (see paragraph 4.16).
- 4.6 With respect to the organizational structure of Banco Departamental de los Andes, fewer hierarchical levels are planned than exist at other financial institutions. This ensures a high degree of motivation among the staff since the best performers will have the opportunity to move up relatively quickly. Annex IV contains further information on organizational structure.
- 4.7 The use of the requested funds will be based on a credit technology developed especially to serve microenterprises, and it has already been implemented by PRO-CREDITO with very favorable results. The regulations applied by PRO-CREDITO in connection with the loans are consistent with Bank policies and will generally be maintained at Banco Departamental. This lending technology has been remarkably effective in that, without any promotion or advertising, PRO-CREDITO, during its first 20 months of operation, made more than 8,500 loans (averaging US\$590) in La Paz and El Alto for a total of more than US\$5 million equivalent. The main features of this financial technology are as follows:
- a. Minimization of risk thanks to a diversified portfolio, i.e., the Bank's target group will consist not only of microenterprises but also of small and medium-sized enterprises from all sectors of the economy;
 - b. Detailed information about customers to offset the lack of collateral security, which requires an exhaustive analysis of the credit applicant's socioeconomic unit as well as strict monitoring of customer payments compliance;
 - c. Long-term business relations based on several successive loans to customers and mutual knowledge.
- 4.8 Banco Departamental de los Andes will make business loans to small business and microenterprises in the commercial, farm and service sectors. The terms and conditions on loans with respect to terms,

amount, form of payment and security are based on, *inter alia*, the results of an analysis of the credit application. This analysis takes into account not only the applicant's creditworthiness but also willingness to repay the loan. In this connection it ought to be mentioned that a fundamental element of the financial technology is the comprehensive analysis of the family unit and the business or production unit and its cash flow. The reason for this is that in the population sector which constitutes the departmental bank's target group the two are normally a single economic unit; seldom does one see a separation between the family budget and that of the business.

- 4.9 The knowledge that the institution acquires about the customer through its exhaustive analysis makes it possible to match security requirements to the customer's economic and social status, maintaining a rational relationship between the amount of the loan and the cost to the borrower of furnishing a particular type of security. This flexibility does not mean that security is not required when available, or not insisted upon in certain cases. The type of security required is tailored to the means of the target group, such as for example collateral in the form of household goods, merchandise and machinery, which may be combined with a personal guarantee. Only in the case of loans involving major risk are mortgages required.
- 4.10 Another important element of the financial technology consists of stringent rules on late payments. An immediate reaction from the loan officer responsible for the overdue loan underscores the institution's strict and sensible attitude toward recovering loans. Through instant monitoring with the aid of specially designed software, Banco Departamental can efficiently manage the risks arising from the insufficient realizable security generally offered by small business and microenterprises.
- 4.11 This financial technology, combined with a high degree of flexibility and quality of service, will make it possible for the Banco Departamental to achieve its objectives in serving the microenterprise sectors efficiently and competitively in the marketplace. At the outset of its operations the Banco Departamental will have the portfolio transferred from PRO-CREDITO, which at the end of September represented almost US\$1 million and more than 2,000 customers. In the next two years the portfolio is expected to grow to almost US\$7 million, so that more than 9,000 customers can be served, according to the projections included in Annex IV.
- 4.12 The average business loan made would be for less than US\$1,000, with a monthly interest rate in dollars of 2.26%, subject to variation as market conditions change. On the basis of experience with the present portfolio, it is estimated that approximately 50% of the customers will be involved in commercial activities, 45% in production and 5% in services. It should be kept in mind that the lending technology used makes for a very accurate fit with market

demand and the specific situation of each customer. In particular, it offers comparative advantages in financing for capital goods and for dynamic small-scale units poised for expansion, compared to the competition, which uses a limited credit menu conditioned on training or compulsory savings. It is therefore felt that the Banco Departamental would stimulate a substantial number of small businesses and microenterprises to step up their use of more capital-intensive methods.

- 4.13 The Banco Departamental de los Andes has a competitor in the Banco Solidario, which began operating in February 1992 and also serves the microenterprise sector, though with a lending technology quite different from that used by the Banco Departamental. However, the data collected through PRO-CREDITO prior to its transformation into the Banco Departamental de los Andes, together with the market analysis (see Annex I), show that the supply of financing in general is well below sector demand, so that there is ample room for these two institutions and more. The unique, attractive and distinctive approach of the Banco Departamental de los Andes makes chances good that it will secure significant market share (Annex II contains more details on the chief competitors).
- 4.14 The Banco Departamental will also offer loans backed by gold. Such lending will generally be aimed at individuals. This service is designed to compete with pawnshops and gold dealers by offering the low-income population an alternative tied to the banking system. Through this service, people can obtain cash immediately in an emergency. PRO-CREDITO has already been offering this service since June and currently (in September 1993) has more than 600 customers, who will be transferred to the Banco Departamental. The goal is to have 5,000 customers within two years with this service alone. The interest on this type of loan would be a 4% monthly dollar rate adjusted by market conditions, and the average amount per loan would be US\$150. This rate is considerably higher than the rate for business loans, mainly because of the higher transaction costs which this kind of financial service entails.
- 4.15 In addition, the Banco Departamental de los Andes will allow the public to maintain savings and time deposits in local currency and in dollars. This service is expected to be offered on advantageous terms for savers, in a manner geared to their needs and guaranteeing reliability and safety. It is estimated that within a period of two years the bank will be able to attract approximately US\$1.2 million, which would equal 16% of its assets.
- 4.16 Since the start of its operations, PRO-CREDITO has received technical assistance from the GTZ, which is providing institutional strengthening in conjunction with the creation of the bank. When the Banco Departamental de los Andes opens its doors it will become the recipient of this technical assistance, with long-term support in the form of: (i) the services of three consultants specializing in the areas of organization, automated control and monitoring

systems, and staff development, (ii) the services of short-term specialists in various areas (e.g., finance, institutional development), and (iii) training.

- 4.17 The nonreimbursable technical-cooperation funding will supplement the technical assistance from the GTZ and will make it possible to develop other innovative financial products meeting the needs of the target population.

V. FEASIBILITY AND RISKS

- 5.1 The economic and financial feasibility of the Banco Departamental de los Andes was examined exhaustively in the feasibility study required and approved by the Office of the Bank Examiner as a step toward authorizing its operation as a regulated financial institution. The financial projections for the first two years included in this study show sustained and upward growth, with moderate profits of approximately US\$23,000 in the first year and US\$247,000 in the second year. This would produce an annual internal rate of return of 23% and a robust net present value. Annex V includes details on the financial projections and the assumptions used.
- 5.2 Although the financial projections are based on plausible and realistic assumptions, the feasibility study also contains a risk and sensitivity analysis that assesses the risks inherent in the calculations effected as well as the consequences of possible developments on the results of the Banco Departamental de los Andes. This analysis covered both risks not specifically tied to banking, such as a worsening of political and economic conditions, lack of demand and wage increases, and specific banking risks, such as uncollectability and withdrawal of deposits (see Annex VI). The analysis shows that even in an extremely negative scenario assuming a 5% increase in all costs and a simultaneous 5% drop in revenues, from the values used in the projections, the Banco Departamental would cover its costs and make a profit of approximately US\$75,000 in the second year.
- 5.3 The risk that the principles and objectives of the Banco Departamental de los Andes will be undermined is virtually nonexistent, given the nature of its stockholders. Both PRO-CREDITO and the international cooperation agencies are non-profit organizations, so that there is no risk of the conflicts of interest that could be expected to arise in the case of participants with differing objectives and outlooks.
- 5.4 From recent changes in Bolivian legislation and regulations governing the country's financial system, it can be assumed that the definitive legal form of the successor financial institution to

PRO-CREDITO could be different from the form of Banco Departamental. In which case, Banco Departamental de Los Andes would naturally be given the equivalent legal form under the new legislation. As the MIF equity investment will not be forthcoming until the new financial institution is authorized to operate as such, this situation does not entail any additional risks for this operation.

5.5 The legal evaluation of this investment operation has identified the following risks:

- a. In cases of losses or undercapitalization, local legislation appears to empower regulatory authorities to order shareholders to make up the capital deficit. In the opinion of the legal advisors consulted in Bolivia, however, the alternatives in practice are confined to placing the financial institution under government supervision or closing it. Should this occur, the financial loss would be limited to the MIF's equity share in the institution.
- b. There are insurance instruments in Bolivia covering the liability of MIF representatives on the board of directors. It may be advisable, however, to establish other formulas to represent the MIF's interests in the institution, such as access to information and books, which would limit liability in terms of the institution's image and operations.
- c. The clause restricting the right of the other shareholders to sell their shares to prospective buyers without the MIF's consent may not be fully enforceable under current legal practice.
- d. Furthermore, legal practice may not recognize the MIF's enjoyment of certain "privileges" (such as the institution's obligation to report to the MIF on any changes in circumstances, the MIF's approval of the auditors, and the MIF's protection against certain risks) vis-à-vis the remaining shareholders, if they are not in agreement.
- e. The obligation of the remaining shareholders to purchase the MIF's shares may be difficult to enforce unless guarantees are required in advance, which is not recommended in view of the project's objectives.

VI. COMPLIANCE WITH PROJECT ELIGIBILITY CRITERIA

- 6.1 The project meets all the eligibility requirements for SEIF financing as set forth in Guideline 4: it would significantly further the growth of private investment, spur microenterprise

activities and strengthen the role played by small business in the Bolivian economy. Furthermore, the project would clearly be useful in three other respects. First, it will have a catalytic effect from its inception, because as soon as the MIF becomes a stockholder the Bolivian stockholders will also increase their capital. Second, the SEIF has a clear role as a lender of last resort in this operation, since the Bank's global credit program for microenterprise is not expected to be executed until 1995 at the earliest. Third, there is no doubt about the project's demonstration effect, since the Banco Departamental de los Andes was planned from the outset as a "pilot bank", namely, as an example for other institutions interested in Bolivia's financial sector reform.

- 6.2 The project's economic and financial feasibility is demonstrated in the feasibility study previously mentioned, which shows the institution's ability to generate the returns necessary to make its loan repayments to the SEIF as well as returns on the direct capital investment. The project's institutional feasibility is ensured by the institutions participating as stockholders and by the qualified staff brought in by the Banco Departamental. The institution will moreover be receiving logistical support and continuing advisory assistance from the GTZ. With respect to economic feasibility, the project would materially benefit the Bolivian economy by spurring activity in the target group and attracting savings, with a significant multiplier effect in terms of job creation and income improvement and distribution in the sectors hardest hit by economic adjustment in Bolivia.

VII. CONSISTENCY WITH THE BANK'S COUNTRY PROGRAM

- 7.1 As specifically laid down in the country programming paper, the Bank will provide direct or indirect support through the MIF for initiatives by NGOs interested in converting to regulated financial institutions. The aim is to reduce their dependence on subsidies and strengthen their institutional capacity in order to increase the supply of financial services made available to the country's microenterprise sector. The ultimate objective of this support would be to help alleviate poverty and marginalization within a large part of the population. Finally, it should be noted that the Government of Bolivia, in official letter 2396/96 from the Ministry of Finance, has issued a statement of nonobjection to this operation.

VIII. TERMS AND CONDITIONS FOR USE OF SEIF RESOURCES

- 8.1 SEIF funding in the amount of US\$2 million would be made available for this project, of which US\$400,000 would be used to purchase shares in the Banco Departamental de los Andes while US\$1.4 million would be extended in the form of a loan, and US\$200,000 in the form of nonreimbursable technical-cooperation funding. Both the loan and the technical-cooperation funding will be provided to the PRO-CREDITO precursor company whereas the equity investment will become effective when the banking institution described herein as Banco Departamental de los Andes is authorized. Its definitive name will be determined in accordance with the legal form accorded under Bolivian legislation. The terms and conditions recommended for this project are as detailed below.

A. Terms of equity investment

- 8.2 Subscription: The MIF will subscribe ordinary shares which will at no time exceed 25% of the total capital stock of the Banco Departamental de los Andes or its successor, at a price not to exceed US\$400,000 equivalent. Other forms of investment (e.g. quasi-equity financing) could be considered at the intermediary's request, provided the project objectives are satisfactorily achieved.
- 8.3 Representation on the board of directors: In return for this subscription, the MIF will be entitled to appoint one member of the board of directors. This member will be appointed by the MIF in consultation with the IDB's Country Office in Bolivia and with the project team, and will be paid according to the procedures and conditions stipulated by the Banco Departamental in connection with directors' fees.
- 8.4 Payment of dividends: The institution's long-term goal is established in its bylaws through the decision to capitalize 100% of net profits generated in order to expand its capital base and underwrite its growth.
- 8.5 Sale of shares: The MIF may sell all or part of its shares starting at the end of the fifth year following the payment of capital, giving preference to the founding stockholders, at a price per share satisfactory to the MIF.
- 8.6 Put option: An option to sell the MIF's shares to PRO-CREDITO may be exercised as from the fifth year but no later than the eighth year following the payment of capital. The price per share, should that option be exercised, will be 1.3 times book value.
- 8.7 The use of a multiple of the book value of the shares in setting a price for the put option is common practice in operations of this

nature. This means sharing the risk but ensuring a minimum return on the investment. Although the proposed price (1.3 times book value) is below the average rate for Latin America, it is similar to the price used by the Inter-American Investment Corporation and the International Finance Corporation and reflects an intention not to place an overly harsh obligation on the buyer. The put option represents a secure way out of this operation for the MIF. If the free sale of the shares (pursuant to paragraph 8.5) generates no interest, the put option could be exercised and PRO-CREDITO would be required to purchase the block of shares.

B. Terms of the loan

- 8.8 The loan, in the amount of US\$1.4 million, will be denominated in U.S. dollars. A term of eight years is proposed with a four-year grace period, repayment in equal semi-annual installments, and an interest rate equal to the higher of: (a) the average of the development credit auction rates set by the Central Bank of Bolivia in the three-month period preceding the date for disbursement of the funds, or (b) the average rate paid on time deposits by Bolivia's major financial institutions, also in the three-month period preceding the date of the disbursement. 2/ If a development credit auction is not held during the three-month period in question, then rate referred to above in point (b) will apply.
- 8.9 Any differential between the institution's cost of funds and the weighted average rate paid on deposits in the financial market will be used to increase the institution's capital.

C. Terms of the nonreimbursable technical-cooperation funding

- 8.10 Nonreimbursable technical-cooperation funding, in an aggregate amount of US\$200,000, will be disbursed to Asociación PRO-CREDITO as a grant, for the purpose of contributing to the institutional strengthening of the institution during its transformation into a financial institution within the banking system.

IX. EVALUATION

- 9.1 The presence of the MIF, through its membership on the board of directors of the Banco Departamental de los Andes, will permit ongoing monitoring and evaluation of the project. This participation in the institution's management will enable the MIF to

2/ The auction is now held every two weeks. Recently, the rates have fluctuated between an annual rate of 9.3% and 10%, based on the United States dollar (in which most financial transactions in the formal system are denominated).

ensure compliance with the project's objectives and with the requirements governing the project's eligibility for financing.

- 9.2 Similarly, reports to stockholders will be required to contain all relevant data on institutional viability, with emphasis on the quality of the portfolio and profitability, to make it possible to measure its capacity for expanding financial services provided to the target group. These reports are also to include data on the scope and quality of the services - e.g., number and characteristics of customers, transaction costs - as well as recommending steps to match services to customer needs.

X. CONDITIONS PRECEDENT TO THE EQUITY INVESTMENT

- 10.1 The MIF equity investment will become effective when the new regulated financial institution is formally authorized to operate as such by the Superintendency of Banks and Financial Institutions of Bolivia.

PROPOSED RESOLUTION

BOLIVIA. FINANCING FOR THE ASOCIACION PRO-CREDITO
AND INVESTMENT FOR THE BANCO DEPARTAMENTAL DE LOS ANDES

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized to enter into such agreement or agreements as may be necessary to: (a) provide both reimbursable and non-reimbursable financing to the Asociación PRO-CREDITO, of the Republic of Bolivia, for the execution of the program referred to in Document MIF/ ; and (b) make an equity investment in the Banco Departamental de los Andes or its legal successor.

2. That up to the amount of US\$2,000,000 is authorized for the purposes indicated in paragraph 1, of which up to the amounts of US\$1,400,000, on a reimbursable basis, and US\$200,000, on a non-reimbursable basis, are authorized for the purposes indicated in paragraph 1(a); and up to the amount of US\$400,000 is authorized to acquire shares of the capital stock of the Banco Departamental de los Andes or its legal successor, in which case the investment shall be limited to up to twenty-five percent of the outstanding stock of the Banco Departamental de los Andes or its legal successor, for the purposes indicated in paragraph 1 (b).

3. That the amounts are chargeable to the resources from the Small Enterprise Investment Fund and the non-reimbursable funds of the Small Enterprise Development Facility of the Multilateral Investment Fund.