SECTION TWO

CASE STUDIES: PROMISING RURAL FINANCE ORGANIZATIONS AND PRODUCTS

RURAL FINANCE ORGANIZATIONS

THE AGROCAPITAL FOUNDATION OF BOLIVIA: PIONEERING INDIVIDUAL LOANS IN RURAL AREAS

Javier Alvarado and Francisco Galarza

INTRODUCTION

The case presented in this chapter, that of the Bolivian NGO "Agrocapital," is particularly important because it demonstrates that it is possible to achieve broad outreach and good financial results with basically agricultural loans, using individual technology and with significant long-term investment-loan portfolios; that is, financing long-term productive activities with average unusually large amounts.

In this sense, this case study breaks with certain financial myths with respect to rural credit and, especially, agricultural loans. Following this introduction, which includes background information on the organization, section 2 describes the credit products offered and the lending technology used. Section 3 analyzes Agrocapital's performance through outreach and sustainability indicators; in the fourth section, the authors draw the main conclusions, indicate the challenges left to face and the conditions needed in order to replicate the Agrocapital experience.

Brief Background on Agrocapital

The Agrocapital foundation is a private, non-profit organization, which was created on January 23rd, 1992, with the mission to contribute to the development of Bolivia's rural areas and settlements in the periphery of cities, by granting short-, medium- and long-term loans to agricultural production, agro industry, transport, marketing and complementary services, directed to medium, small and micro business using traditional or modern technology (Cáceres, 1999). A notable factor within the mission statement of Agrocapital is that, since its beginnings, it has aimed at providing financial services in a sustainable and efficient manner, so that, from the start, the objective of achieving sustainability was defined very clearly and as part of the organization's philosophy.

Agrocapital was founded with the sponsorship of the Bolivian government and the US Agency for International Development (USAID), an equity contribution from the Executive Secretariat of Public Law (P. L.) 480 and the technical assistance from the US NGO Agricultural Cooperative Development International (ACDI) to support alternative development programs promoted by the Bolivian and US governments. The initial goal of Agrocapital was thereby to manage a credit program for farmers interested in substituting coca growing in the areas of El Chapare and the upper valleys of the Department of Cochabamba, as well as in the province of Ichilo, in the Department of Santa Cruz. These areas responded to the objectives put forth by the Bolivian government and USAID-Bolivia. Later on, the outreach of the program was broadened to include other areas, distinct from the coca-producing areas, where financing needs were not being answered.

Granting loans to the rural sector, particularly the agricultural sector, involves, a series of challenges, which Agrocapital had to face. Among them, the most significant were: relying on a structure that responded to the needs and particularities of the rural sector, risks, kinds of production, customs, etc.; designing an appropriate lending technology for the characteristics of the area; hiring personnel, professionals and clerks with lending experience in rural areas; avoiding political meddling that could affect the running of the organization; developing rules and procedures for efficient loan provisions; and consolidating the organization's position as a stable, lasting source of financing. As will be seen further, all these challenges have been taken on with great success. Currently, Agrocapital's major challenge is to transform into an institution regulated as a Private Financial Fund (*Fondo Financiero Privado* (FFP)).

Agrocapital's organizational structure has a Board of Directors as its highest governing body. It defines organizational policies and makes decisions by simple majority vote. The members of the original Board were chosen through a process coordinated by the Executive Secretariat of the P. L. 480 and USAID-Bolivia. The by-laws establish that the oldest directors shall propose a short list to P. L. 480 and USAID-Bolivia to complete the number of directors, from three to five. Choosing new directors through this electoral process has worked quite well; the Board's decisions were not influenced by any political interference on the part of USAID and P. L. 480, and, hence, no governance problems have arisen in the organization.

The Executive Committee is made up of the General Manager and the Financial, Loan and Operation Managers who, in turn, are in charge of the coordination, direction and control of the activities of the 10 branches. The General Manager supervises these three Managers and is responsible for reaching and ensuring the achievement of the annual objectives and goals set by the Board, as well as ensuring the sustainable growth and development of the institution. The General Manager also makes policy and goal proposals to the Board and independently conducts the organization's administrative duties to comply with it institutional obligations.[1]

At the end of 2000, the geographic area of operation included Bolivia's three main Departments: La Paz, Cochabamba, where Agrocapital's head offices are located, and Santa Cruz, with a staff of 60 people, 17 of whom were loan officers, 7 in investment and 10 in microfinance, and a loan supervisor. All the areas of operations are considered to be rural or peri urban by Agrocapital. With respect to the area served, the aforementioned Departments include almost 70 percent of Bolivia's total population and are three of the more prosperous Departments with the best roads and physical infrastructure.

The funds intermediated by Agrocapital in 1998 came substantially from its own resources, (42 percent) but also included external sources: the Foundation for Production (Fundación para la Producción, FUNDAPRO), the Financial System Development Fund (Fondo de Desarrollo del Sistema Financiero, FONDESIF), the Andean Development Corporation (Corporación Andina de Fomento, CAF) and the Inter-American Development Bank (IDB).

Through its transformation into an FFP, Agrocapital aims at increasing the scale of its operations by means of greater access to sources of funds, deposits and other sources, which will enable it to diversify its portfolio and achieve better results in terms of outreach and sustainability. As usual in such cases, the NGO, Agrocapital, will transfer its portfolio to a regulated institution, an FFP.[2]

PRODUCT DESCRIPTION AND OPERATION[3]

Product Description

Agrocapital offers exclusively loan products, divided into two product lines: microfinance, which represented 31.6 percent of the portfolio and 82.6 percent of outstanding loans in December 1998 (and similar percentages in 1999), and long-term investment loans (see Table 5.1).

1 Furthermore, once the FFP is constituted, foundation representatives on the FFP Board will be chosen from within the Foundation's Board.

2 According to Agrocapital employees, the institution should have been operating as an FFP by the first quarter of 2001. However, at the end of 2002, the conversion still had not materialized.

3 The information provided in this section refers basically to the situation that existed in 1998 and, to a lesser degree, in 1999. In the following years, in particular in 2000 and 2001, Agrocapital launched a consumer microcredit product —*crediconsumo*— (in bolivianos and in dollars), replacing the so-called maxicréditos in dollars and involving lower amounts than the latter. In addition, single-signature loans were eliminated, due to the major risks generated by the economic crisis, growing delinquency rates and the problem of collusion among borrowers. Despite all this, the basic principles and procedures involved in the application of the lending technology to portfolio management and the transparency of the information have remained the same.

The Microfinance Product Line

The microfinance product line is the smaller of the two lines and is aimed at financing productive, commercial and service activities in rural and urban areas with working and investment capital. Loans range from US$ 544 to US$ 10,000 with terms of up to 24 months. The line includes three products: microcredits in dollars, microcredits in bolivianos (Bs) and *maxicréditos* in dollars. This last product is used to finance higher-income clients.

The Investment Product Line

The investment product line is for small and medium rural businesses with expanding economic activities requiring fixed assets or operating capital. Terms and Conditions are therefore different than those in the microfinance product line. The investment product line offers two types of loans: "investment" loans and "single-signature" loans. In the first case, the minimum amount depends on the guarantees and the ability to cover at least 20 percent of the investment (see Table 5.1). The single-signature loan is used to cover temporary needs for cash on the part of investment-line clients who have been with the organization at least one year and have a good credit history. However, single-signature loans have not been used since the year 2000.

2.1.1 Terms

Maximum terms in the case of the microfinance product line vary according to the number of sequential loans; minimum loans, or maximum first loans, are listed in Table 5.1. Maximum terms may be 12, 18 or 24 months, respectively, according to the following ranges:

(i) For microcredits in bolivianos (Bs), ranges are: (i) under the equivalent of US$ 1,088; (ii) from US$ 1,088 to US$ 2,357; and (iii) from US$ 2,357 to US$ 5,444.

(ii) For microcredits in dollars, ranges are: (i) under US$ 1,200; (ii) from US$ 1,200 to US$ 2,600; and (iii) from US$ 2,600 to US$ 6,000.

(iii) For maxicréditos, ranges are: (i) under US$ 3,000; (ii) from US$ 3,000 to US$ 6,000; and (iii) from US$ 6,000 to US$ 10,000.

In the case of investment loans, maximum terms are in accordance with the amount of the loan and may be as follows:

(i) Up to US$ 5,000: 2.5 years;

(ii) from US$ 5,000 to US$ 10,000: 4 years; and

(iii) over US$ 10,000: 5 years.

Table 5.1. Features of the Different Types of Loans, 1998-1999

Type of loan	Objective	Amounts (equivalent in US$)		Term
		Minimum	Maximum	
Microfinance line				
• Microcredit in Bs	To finance rural and urban agricultural, commercial and service activities.	544	5,444	1 - 24 months
• Microcredit in US$		600	6,000	
• *Maxicrédito* in US$		1,000	10,000	
Investment line				
• Investment loan	To finance small and medium rural businesses. Normally a three to four year mortgage, in bolivianos or dollars, with interests varying according to the amount of the loan.	Not available	300,000	1 - 60 months
• Single-signature loan	To cover temporary cash requirements.	variable[a]	variable[a]	8 - 12 months

[a] In the case of single-signature loans, the maximum amount is defined as the minimum amount between the two following variables: an amount equivalent to the total amortized amount from the Last Approved Total Risk (*Último Riesgo Total Aprobado* (URTA)), 25 percent of the URTA and US$ 20,000.

N.B.: the URTA is equal to the sum of all loan balances, including clients' last operation at the time of the approval of the latest loan granted to them.

Source: Agrocapital.

At the end of 1998, since most of the portfolio balance was going to investment in fixed assets and working capital, the investment product line predominated (68.4 percent of the portfolio), a great proportion was lent for medium terms. Sixty-four percent of the portfolio had a term of over two years and 73 percent of more than one year. In late 2001, the concentration in the investment product line was even more pronounced 74 percent of the portfolio and the percentages of portfolio terms longer than two years and one year were 70.5 percent and 90.3 percent, respectively. This difference is crucial compared to the majority microfinance organizations, which basically offer short-term loans for working capital of one year or less.

Clientele

Agrocapital's clients work in agriculture, agroindustry and trade in rural and disadvantaged urban areas of the Departments of Cochabamba, Santa Cruz and La Paz. There is a clear distinction between clients in the eastern region, Santa Cruz, on one hand, and those of Cochabamba and El Alto, on the other. While the former own property ranging from 20 to 50 hectares on average, use modern technology and grow crops for off-farm sale, the latter own property between one and three hectares of land, use traditional technology, grow crops for direct consumption and make intensive use of family labor.

A feature common to all clients is that everyone has land titles and they are recorded in the Public Registry. Another characteristic is that the great majority of clients who make a living from agriculture have only completed primary education, while those involved in trade have a higher level of education and are, for the most part, migrants from rural areas. Investment-line clients have the highest level of education. Gender is closely linked to the financed activity. In the case of agriculture, most clients are men, while in trade and services 71 percent of loans went to women total. Overall, 41 percent of the portfolio in 1998, and 48 percent of the portfolio in 2001 (see Table 5.5), went to women.

Although it is true that, within Agrocapital's portfolio, small producers have always been important, the greater volume of its portfolio is concentrated in loan sizes over US$ 5,000. In the past three years, the importance of loans under US$ 1,000 has substantially dropped. While in 1998, 33 percent of the portfolio was made up of loans under US$ 500 and 54.4 percent were loans under US$ 1,000, only 22 percent of loans were under US$ 1,000 in 2001. On the other hand, in 1998, loan amounts ranging from US$ 5,000 to US$-50,000 represented 53.5 percent of the total balance and, in 2001, that percentage was 60.2 percent (see Table 5.4). This means that Agrocapital actually grants many small and medium-size loans (microfinance line) and few large loans (investment line). This characteristic enables it to better diversify the risks.

In late 1999, Agrocapital's Board estimated that their clients' profile would not change significantly after its transformation into an FFP; at least, not in its lending operations. The Board pointed out that services would continue to be offered to small and medium business in rural and marginal urban areas, but with a greater range of financial services. From the information available, it may be observed that this appears to be true, although, in 2000 and 2001, there was a greater concentration of loans for relatively high amounts (investment product line) and a drop in the significance of loans to micro and small producers (microfinance product line), in their number and amounts.

Competition

The actual competition that Agrocapital faced up to mid-2000 was quite reduced and basically limited to NGOs that offered rural credit (Fundación para la Promoción y Desarrollo de la Microempresa (PRODEM), Fundación para Alternativas de Desarrollo (FADES), Sartawi, and the Instituto para el Desarrollo de la Pequeña Unidad Productiva (IDEPRO)), since the few banks that worked in the agricultural sector only financed large-scale producers, and savings and loans cooperatives were and continue to be of little importance, due to their problems in becoming profitable organizations[4]. In short, NGOs only recently began working in Agrocapital's spheres of operation and are still not considered serious competition.

4 A high-level official of the Banco de Santa Cruz, present in the same geographical sphere as the Montero branch, Agrocapital's most active branch, stated that his Bank was only interested in a clientele of producers who owned at least 500 hectares.

Agrocapital's competition can be better assessed when considering the characteristics of the products offered and the Departments where such NGOs are present. In the first place, no major competition with the investment product line seems to exist, since most NGOs offer short-term loans and their portfolios contain a high concentration of very small loans. This is why the competition would seem to be more with the microfinance product line, which represented 29 percent of Agrocapital's portfolio and 78 percent of outstanding loans in 2000. This implies that Agrocapital is in a very strong position as investment loan supplier and, insofar as it offers microfinance products better adjusted to the characteristics of applicants, that, is, better quality products, it will be able to face competition more efficiently.

Second, data available for 2000 shows that, except for La Paz, where Agrocapital had four percent of its portfolio, competition could come from FADES, which, in 2000, held 25 percent of its portfolio in Cochabamba and Santa Cruz (US$ 2.9 million), and Sartawi, which could compete only in Cochabamba, where it held a portfolio little over US$ 750,000 (1998). The market share of PRODEM's portfolio in Santa Cruz and Cochabamba in 2000 is not precisely known; however, due to its national scope, greater portfolio volume and experience, Agrocapital's management identified this institution as their main competition, even though FADES significantly increased its presence in the above-mentioned Departments since 1998, with the opening of new branches in Santa Cruz (a regional office and branches in Cuatro Cañadas and Montero) and Cochabamba (branches in Quillacollo and Capinota),[5] where Agrocapital also operates.

FFPs that have made incursions into rural areas are viewed as serious future competitors, although, in late 1998, they still did not constitute considerable competition. However, it does seem that competition has increased with the entry of the PRODEM FFP in late 1999 and the above-mentioned expansion of FADES since 1998.[6]

Lending Technology

Agrocapital is one of the first finance NGOs that began to grant loans with a clearly individual technology and for amounts over US$ 10,000, an unusual fact in Bolivia's rural finance, even today. Despite this difference with most Bolivian microfinance organizations, results have been quite satisfactory, as will be seen further. Agrocapital's lending technology has been another cornerstone of its success on Bolivia's rural financial markets. Its technology adapts very well to the characteristics and needs of its target-clientele, especially taking into account that the terms and conditions of the loan contracts are specific to each client.

5 With the opening of these new branches, FADES' portfolio in Santa Cruz and Cochabamba has grown from a little over US$ 1 million in 1998 to US$ 2.9 million. Consequently, the proportion of these Departments in its total portfolio grew from 11 percent in 1998, to 25 percent in 2000.

6 Incursions by the Ecofuturo and PRODEM FFPs in 1999 has pushed the diversification of FFP portfolios toward rural areas, which is reflected by a rise in the number rural branches, from 9 in late 1999 to 46 in 2000, while their number of urban branches increased from 80 to 93 over the same period.

One of the most important principles of the lending technology is that all activities that demonstrate economic and technical feasibility, not only agricultural activities, are financed. This has broadened the spectrum of intervention in favor of Bolivia's small and micro rural businesses and has allowed the diversity of their activities to be recognized. Furthermore, a significant profit margin must be demonstrated, as a factor that minimizes the probability of default on payment due to external events. This ensures better control over systemic risk.

Loan Officers

Selection Process and Incentives

The selection process of loan officers is always based on internal competitions, as a matter of institutional policy, to determine if an employee satisfies the required loan-officer profile. When there are no internal candidates, a public competition is launched. Once the applications are received, an initial screening of applicants is carried out.

After this first screening, finalists are evaluated on their knowledge of financial issues by written exam. The General Manager and the Finance, Operation and Credit Managers interview those who obtain the three highest marks. Their decision to hire one of the three candidates is final.

In general, criteria for the selection of loan officers are as follows:

(i)credit experience and knowledge of the local area (fundamental);

(ii) professional training;

(iii) negotiation and communication skills;

(iv) ethical standards and transparency, and

(v) reliability and good organizational skills.

Following the hiring, the chosen applicant goes through a learning stage to assimilate Agrocapital's internal regulations, manuals and procedures. Once this stage is completed, the loan officer is transferred to the branch where he or she works and is provided a week of training on the rules, manual and lending technology in general: credit procedures, client supervision mechanisms, loan collection, etc., as well as on the computer system. When this phase is finished, an area of operation is assigned to the new loan officer.

In terms of incentives, Agrocapital offers higher pay than the market average US$ 975 per month (almost equivalent to Bolivia's yearly *per capita* Gross Domestic Product), accident and life insurance, and a good work environment. In addition, an important non-monetary incentive is the prestige attached with working at Agrocapital, which could increase the "value" of the loan officer's work on the job market.

Furthermore, since the start of the year 2000, additional incentives have been offered to the best loan officers: cash, trips for officers and their spouse, electrical appliances and morale boosters certificates. To determine who are the best loan officers, portfolio volume, delinquency, rate and precautions against uncollectable loans, portfolio graded as unrecoverable, are taken into consideration.

Loan Officer Profile

All loan officers are originally from their area of operation, and their pay depends on their experience and education level. Officers working in the microfinance product line usually receive lower salaries than those in the investment line. Incentives to perform efficiently come through pay and the prestige associated with working with Agrocapital.

The academic background of the loan officers varies according to the type of loans granted. Those working in microfinance tend to be agronomists, agricultural technicians or students not necessarily at university level. In this case, what they lack in terms of formal education is largely compensated by the loan officers' extensive experience in the area and knowledge of, lending activities, a basic selection requirement. The fact that loan officers live in the areas where they work enables them to maintain permanent and close contact with clients and to reduce the possibility of information asymmetries in the client screening process. In sum, university education is desirable, but not indispensable, in order to be hired as a loan officer in the microfinance product line. In the investment product line, however, loan officers are qualified agronomists or industrial engineers. This greater degree of qualification responds to the need for more exhaustive assessments in the case of investment loans.

Given the importance of its lending technology for Agrocapital, loan officers in both product lines are constantly assessed and supervised by the National Loan Supervisor (Supervisor Nacional de Créditos), who reviews the reports presented by loan officers and checks client files. This is a good way to ensure that loan officers comply with the organization's lending regulations and thereby prevents bad loan allocation, thus helping to ensure a high quality portfolio.

Loan officers are in charge of every step of the lending process and follow the procedures laid out in the loan manual. In both product lines, a common element is to ensure good client screening and protection against the risks of reimbursement default.

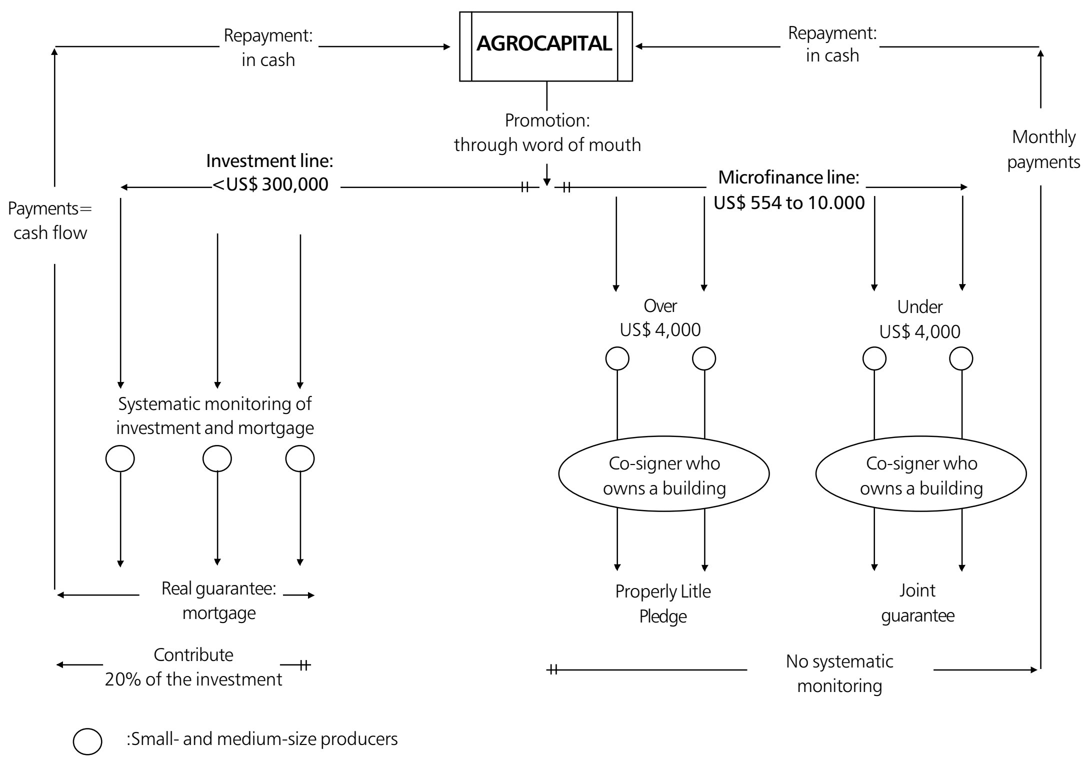
Client Screening Process: the Key to Efficient Recovery

The first action in this process consists in identifying the geographic areas and productive sectors and subsectors within the branches' area of influence. Then, clients themselves promote the products offered by Agrocapital among their neighbors, which lowers costs. In terms of evaluating the credit history of an applicant, in all cases, regardless of amount or risk, the credit bureau of the Asociación de

Bancos and a private credit bureau, DATASI, are consulted to verify information on applicants, their spouse, and the co-signer (guarantor), should there be one. Good references from suppliers, neighbors, creditors, etc., are also important. In this sense, information management is an important factor in Agrocapital' technology.

The screening itself is normally carried out through an analysis of the family unit's ability to pay, conducted during a visit by the loan officer to the applicant and subsequent construction of a family-unit cash-flow scheme (see Figure 5.1 for a graphic presentation of this lending technology).

Figure 5.1. Agrocapital's Lending Technology Outline



The conditions to obtain a loan from the microfinance product line are as follows:

(i) Applicants must have at least one year of experience in their line of business and have lived at least a year in one of the areas where Agrocapital provides services, in the case of microcredits, and three years in the case of maxicréditos. This requisite is important because it prevents granting loans to people who continually migrate to other regions. Residency is easy to check since loan officers are natives of the areas where they work.

(ii) Good references from any of the following: neighbors, creditors, clients, relatives, etc.; and, of course, from the credit bureau.

(iii) Microcredit applicants must prove that they own enough equity (stoves, electrical appliances, television sets, beds, furniture, etc.) to cover at least twice the amount of the loan and, in the case of *maxicréditos*, three times the amount to be lent. Of course, in addition, to complying with these ratios, the ceilings on loans listed in Table 5.1 are also taken into account.

(iv) In terms of collateral, in the case of microfinance loans, a joint guarantee (personal guarantee) is required, as well as ownership of a building in town. For microcredits in bolivianos greater than 10,000 bolivianos or US$ 1,800, micro credits in dollars over US$ 2,000 and maxicréditos greater than US$ 4,000, the original property title of a movable personal property is required to be pledged. In the case of microcredits to finance agricultural or remote activities, this requisite applies from the first loan on.[7] To raise the effectiveness of this requisite, recording the title in Public Registries is planned to be required, in order to ensure that the guarantor has not already presented the same title to back other loans.

(v) Another condition to access credit is to demonstrate sufficient ability to pay to cover the loan, by having a minimum ratio of cash-flow surplus to installment of two to one. This requisite establishes an important client characteristic: the productivity and dynamism of their business or activity, which ensures their ability to pay, even in adverse conditions. This requisite compensates for the lack of real guarantees in this type of loan.

(vi) The microcredit loan officer's visit to the home or business to check the place of residence and obtain the necessary information to evaluate the loan application.

All these factors together ensure that loan contracts are drawn up to agree with the real needs of applicants.

7 An activity is considered "remote" from a branch when it takes place (1) over 10 kilometers from a paved road, (2) over 3 kilometers from a secondary road or (3) a combination of both, up to a total of 10 kilometers.

In the case of investment loans, the main requisites are as follows:

(i) Good credit history.

(ii) Applicants' project or business must be located in one of the areas of influence, of one of Agrocapital's branches. This requisite is meant to lower transaction costs.

(iii) To prove the economic and financial feasibility of the project, according to the cash flow outline prepared by the loan officer.

(iv) To have real guarantees, mostly mortgages, with a value on seizure that covers at least the total value of the loan.[8] The loan officer will assess this value.

(v) To contribute at least 20 percent of the investment. This requisite is meant to share the lending risk with clients.

(vi) A visit from the loan officer to the business or place where the guarantees are found to assess the feasibility of accepting them and obtaining the necessary information, items (2) to (5), to evaluate the loan application.

(vii) In addition to the above-mentioned requisites, the loan officer must conduct a sensitivity analysis, which, in the case of agricultural loans, includes variables such as prices, earnings, production volumes, sowed area and demand, to establish applicants' ability to pay in situations that may prove critical to the activity. In other cases, prices, production and market behavior are taken into account.

Finally, in the case of single-signature loans (granted up until 1999), reserved for clients of the investment product line only, applicants had to comply with the following conditions:

(i) To amortize at least a fourth of the capital lent on the first Agrocapital loan.

(ii) To have a minimum of one year of experience with investment loans.

(iii) To have not registered any delays on installment payments over 15 days on any of their loans or an accumulated total of 30 days on loans obtained over the two previous years.

An important point for the speed of outreach expansion is the simplification of loan approval instances up to a certain amount. Loan officers have the authority to

8 As a result of the collateral requirement, the portfolio per guarantee type at the end of 1998 showed that 66.6 percent of it was backed by mortgages, 31.6 percent by personal guarantees and the remaining 1.8 percent by no guarantee at all. The collateral requirement increased in the following years. In 2001, every loan was backed by some kind of collateral: 74.5 percent by mortgages and 25.4 percent by personal guarantees. This increased requirement for collateral coincided with a greater concentration of loans over US$ 5,000: 71 percent of the portfolio in 2001.

approve a loan for up to US$ 20,000. In case the loan is over that amount, the Credit Manager makes the final decision on it.

Once the loan has been approved, the Legal Area is in charge of the contract in case of investment loans and clients themselves must deliver a notarized certificate of the contract and record the mortgage with the Office of Deeds, Public Registry. In the case of a loan from the microfinance product line, loan officers themselves draw the agreement, approve it and authenticate clients' and guarantors' signatures, only legal requisite; all this can be done in a single day.

As an Agrocapital employee indicated, there is no estimate of the time those disbursements may take following the presentation of applications, but what is known is that, in the case of investment loans, the delay is greater. Disbursements are made through checks from the banks nearest the areas where the loan application was made.

In terms of installment amortization, payments are generally monthly for all loans in the microfinance line, with the exception of agricultural loans, which depend on each borrower's cash flow, in order to take into account seasonal incomes. In the case of the investment line, the timeframe also depends on each borrower's cash flow. Interests are calculated on the remaining capital, so that if clients pay ahead of the established term, they pay less interest.

In summary, amounts, terms and forms of payment (characteristics of the loan contract) depend on the ability to pay of loan applicants and how seasonal their incomes are.

Same Applicants for New Loans

The policy Agrocapital follows in granting new loans depends on prior loan payment records, but without neglecting the evaluation of the current ability to pay. This works as an incentive for compliance and contributes to the creation of a culture of repayment. In fact, to have access to a new loan from the microfinance product line, in addition to the initial conditions pointed out, borrowers must demonstrate punctuality in payment and not present a deteriorating economic or personal situation.

Increases in the amounts are sequential and the maximum terms vary according to amounts and the number of sequential loans, as shown in Table 5.1. Normally, disbursements of second loans are quicker than for first loans in this line; but in the case of investment loans, the delay is essentially the same, since loan applications are evaluated as if they were first-time applications.

In loans from the microfinance product line, there are four cases in which new loans may be granted, depending on the number of days of overdue payments on prior loans and taking into account the ability to pay.

(i) If non-compliance with the prior loan contract is under 10 days, the borrower may obtain a new loan for a greater amount;

(ii) If non-compliance ranges from 11 to 20 days, the same amount is granted;

(iii) If it ranges from 21 to 30 days, new loans are suspended for three months and, following that, the same amount is granted, but the contract is subject to the decision the Credit Manager.

(iv) Finally, if non-compliance is over 30 days, no new loans are granted, in spite of reasons that may explain the delay.

In the case of the investment product line, there is no established timetable, but overdue days are also taken into account, as well as causes for the delay in repaying prior loans. Furthermore, credit evaluations for new loans are conducted case by case and new loans are granted to delinquent clients only in case of past insolvency, not when there is unwillingness to pay. Managing the information that loan officers have on hand is critical in determining if the problem is one of insolvency or unwillingness to pay.

Loan Monitoring and Recovery

In the case of microfinance loans, no systematic monitoring takes place during the valid term of the loan, which means that, any visit to a client during this period is not programmed, but rather the result of taking advantage of other business the loan officer may have nearby. When payments are on a monthly basis, in practice, this frequency acts as a preventive monitoring mechanism.

Nevertheless, should a client not comply with the payment of an installment, a mandatory visit is carried out. In every case, the use of the loan is always checked. After an installment payment is overdue two or three days, a payment pre-notification is issued, personally or by phone. If non-compliance continues for over 90 days, the seizure is carried out according to the Law, with the authorization of the Credit Manager. This last procedure is similar for loans from the investment product line.

In the case of an investment loan, monitoring is stricter and more comprehensive. The process includes both collateral per se, to check if anything may affect its value, and the actual investment, that is, the use of the loan. Furthermore, before an installment is due, usually one-month prior, reminders are sent or telephone calls made to borrowers. After non-payment of an installment, a visit is conducted between the fourth and sixth week, to investigate the motives for the delay: inability or unwillingness to pay. Once this is established, two possibilities exist: (1) the client recognizes the debt and agrees to pay or (2) the client refuses to do so. In the first case, possible rescheduling is analyzed, if so, the loan is treated as a new one: the loan is "cleaned out" of the portfolio. In the latter case, collateral seizure is carried out according to the Law.

To determine if nonpayment was due to inability or unwillingness to pay, two factors are taken into account in all loans: (1) knowledge of the performance of the economic sectors and subsectors in the area of each branch to be aware of any event that may have affected the client's ability to pay; and (2) visits to clients by loan officers, who assess the causes of the delay on the spot.

Apart from good credit history, which means paying on time, another important incentive for complying with installments payments on a first loan is that the following loan contracts will take into account the number of days overdue, as indicated above. In addition, microfinance line clients who are over thirty days behind on their prior loan are definitely discarded from obtaining new loans.

Interest Rates

Interest rates are based on relevant markets, risks and amounts. In the case of microcredit, in 1998, rates ranged from 30 percent to 42 percent annually in bolivianos and from 24 percent to 36 percent in dollars. In the case of *maxicréditos*, the rates varied between 21 percent and 30 percent. These rates may rise by six percentage points in the case of microcredits, when these are meant to finance agricultural activities considered "riskier", according to loan officers' evaluations, and that are "remote" from the branches.[9]

In the case of investment loans, the rate in US dollars ranged from 15 percent to 23 percent, depending on the amount of the loan. This rate is adjusted according to the type of loan, its location, term and collateral.[10] Finally, for single-signature loans, the rates in place in 1998 oscillated between 19 percent and 25 percent, depending on loan amounts, and were adjusted according to the type of loan and location of the financed activities.

Setting interest rates therefore depends on amount, insolvency risk, monitoring costs and recovery of each particular client's loans. This way, *ad hoc* loan contracts may be designed and, consequently, the situation of each borrower may be identified more precisely, which, in turn, helps to improve the quality of the financial products on offer.

Finally, every client must make a single set payment of US$ 800 on disbursement to cover the costs of loan application evaluation. There are no other explicit fees, but the possibility of charging for credit insurance being studied.

Operation Expansion

One of the decisive components of Agrocapital's operation is that both product design and lending technology were normally preceded by market surveys in their areas of operation. Such studies identified the existence of an unsatisfied demand

9 See footnote 7.

10 The same distance criteria as in the microfinance product line are maintained.

in specific areas, as well as the characteristics of potential clients, so that expansion was launched with the knowledge that Agrocapital was entering a new, safe and profitable market niche.

Moreover, branches have expanded into areas of production where irrigation is accessible, that is, expansion has been cautious. These factors constitute an important component of the strategy to broaden and consolidate activities, as well as the adaptation of Agrocapital's lending technology. When Agrocapital opened a new branch and expanded operations, it was clearly aware of the type of market it faced.

As a result of the above, Agrocapital concentrated its activities in the Departments of La Paz, Santa Cruz and Cochabamba, where rural areas have the communication infrastructure necessary to ensure that information is delivered safely and daily to the main office, located in Cochabamba. In addition, these Departments' rural areas present greater economic potential than the rest, and unsatisfied demand for the financial services provided by Agrocapital.

As indicated above, Agrocapital launched its operations in Cochabamba as a USAID initiative. USAID was interested in having a loan program for farmers willing to substitute their coca crops. Later on, Agrocapital went through three stages of evolution.[11] First a period of two years to test the lending technology, technical assistance and administrative policies. At the same time, market studies were conducted in potential areas of action. Second, Agrocapital broadened its geographic scope, consolidated its presence on new markets and became progressively self-sustainable. In the years that followed, after checking the existence of a large, unsatisfied demand for credit in different coca-producing areas. Third, in 1997 and 1998, Agrocapital began to prepare its transformation into a FFP; to do so, it started to purchase assets, hire key personnel and train staff for new activities, in order for the transformation into a regulated institution to be smooth and non-traumatic. Nonetheless, as mentioned above, the transformation has yet to take place.

PERFORMANCE ANALYSIS

Outreach

In its eight years of existence, Agrocapital has approved a total of 25,068 loans, 92 percent of which in the microfinance line and eight percent in the investment line, as shown in Table 5.2. The total amount approved from 1992 to 1999 was US$ 48.7 million, 43.5 percent in microfinance and 56.5 percent in investment (see Table 5.3). In 1999, loans ranging from US$ 78 to US$ 50,000 were approved.

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11 This information, as well as much of the data presented in this document, is based on Agrocapital's 1998 annual report, provided by the organization.

Table 5.2. Number of Approved Loans

Product line	1992	1993	1994	1995	1996	1997	1998	1999	Total
Investment	182	165	164	335	260	301	232	304	1,943
Microfinance	0	44	591	3,580	5,024	5,488	4,611	3,787	23,125
Total	182	209	755	3,915	5,284	5,789	4,843	4,091	25,068

Source: Agrocapital.

Table 5.3. Approved Loan Amounts

Product line	1992	1993	1994	1995	1996	1997	1998	1999
Investment (thousands of US$)	1,630	1,946	1,716	4,707	4,604	4,837	3,840	4,224
Microfinance (thousands of US$)	0	12	194	1,472	2,491	3,825	6,411	6,765
Total	1,630	1,958	1,910	6,178	7,095	8,662	10,251	10,989
Average (US$)								
Investment Line	8,959	11,795	10,464	14,049	17,707	16,069	16,553	13,894
Microfinance Line	0	266	328	411	496	697	1,390	1,786
Global average	8,959	9,368	2,529	1,578	1,343	1,496	2,117	2,686

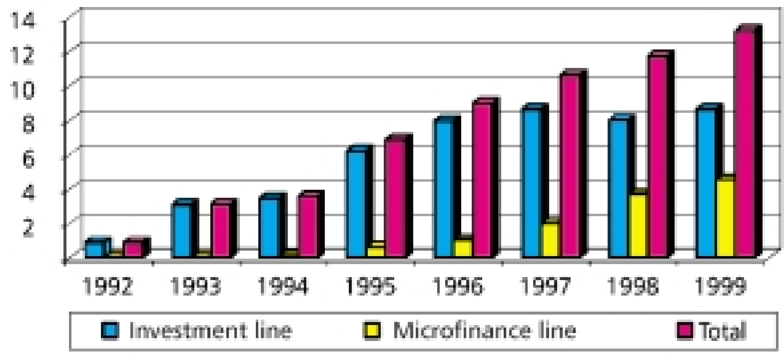
Source: Agrocapital.

As of December 31st, 1998, Agrocapital's outreach included 4,333 clients with outstanding loans that added up to a total of 4,436 and a portfolio balance of US$ 11,735,819. One year later, it had 4,524 outstanding loans and a portfolio balance of US$ 13,191,282. Growth, both in the number of outstanding loans and portfolio balance, was spectacular from its creation in 1992 to 1999: an annual average of 54 percent (and 47 percent) in terms of the above-mentioned balance (see Figure 5.2). However, more recent data display portfolio shrinkage in 2000 and 2001.[12] This is a result of the generalized crisis faced by the Bolivian microfinance market over the past three years, which has also affected Agrocapital.[13] As will be seen further, this crisis caused a deterioration in the institution's financial indicators.

12 Gross portfolio balance decreased by 9.4 percent in 2000, and 11.4 percent in 2001.

13 The generalized reduction of the ability to pay, caused by the economic crisis, and the deterioration of a culture of repayment, encouraged by borrowers' pressure to obtain better payment conditions, generated an uncommon rise in delinquency rates. In the case of banks, the rate increased from 4.6 percent in 1998 to 11.6 percent in 2000, as described in Chapter 3 (see section III, part C, Table 3.18).

Figure 5.2. Evolution of Portfolio Balance
(in thousands of US$)



Source: Agrocapital.

Finally, the number of loans and the portfolio balance do not vary very much from one month to the next. Monthly average in both cases are quite similar to those registered in December of each year. In 1999, the average monthly balance was US$ 12.06 million versus a balance of US$ 13.19 million in December.

Portfolio Depth

In terms of the depth of Agrocapital's outreach, average loan size as of December 1999 was US$ 2,916. The average amount of approved loans that same year was US$ 1,786 in the microfinance line and US$ 13,894 in the investment line, for a global average of US$ 2,686 (see Table 5.3). The average loan remained relatively stable from 1995 to 1999 (around US$ 2,600), which could mean that the type of clientele also remained constant. However, average loan size grew by 21.1 percent in 2001 with respect to 1999, which may indicate a change in the makeup of the clientele toward higher-income clients. This is shown by the importance gained by the investment line in the portfolio in 2001 (74.1 percent of the balance and 29.4 percent of outstanding loans), with regard to 1999 (65.4 percent and 17.9 percent, respectively).

Based on December 2001 figures, the makeup of the portfolio, according to loan ranges, indicates that loans are heavily concentrated in the US$ 1,000 to US$ 50,000 range. While, only 2.7 percent of the total balance was under US$ 1,000, 60.2 percent was in the US$ 5,000 to US$ 50,000 range (see Table 5.4). Furthermore, the number of outstanding loans was concentrated in the under US$ 5,000 constitute 78.2 percent of the portfolio, indicating that a majority of clients were small producers who obtain small loans from the microfinance product line.[14] Even though Agrocapital

14 These percentages have varied substantially since 1998, the year when loans under US$ 1,000 represented 9.4 percent of portfolio balance and 54.4 percent of outstanding loans. Since then, loans have been gradually more concentrated in the US$ 1,000 to US$ 5,000 range, and loans under US$ 1,000 have lost importance, from the point of view of both balances and actual number of loans.

has remained loyal to its original target-group over the years, which is demonstrated by the fact that from 1996 to 1998 the distribution of the number of loans according to size was roughly similar to the period from 1999 to 2001, there seems to have been a growing concentration of higher-income clients, as seen in Table 5.4.

Table 5.4. Portfolio Structure According to Loan Ranges

Range	2001		1998	2001		1998
	Balance (US$)	%	%	N.° loans	%	%
De 0 to 500	45,799	0.4	3.3	178	5.9	33.3
De 501 to 1,000	244,797	2.3	6.1	482	16.1	21.1
De 1,001 to 5,000	2,809,793	26.5	29.2	1,684	56.2	35.3
De 5,001 to 10,000	1,320,224	12.5	14.6	269	9.0	5.2
De 10,001 to 20,000	2,060,584	19.5	16.7	219	7.3	3.1
De 20,001 to 50,000	2,996,723	28.3	22.1	143	4.8	1.8
De 50,001 to 75,000	537,255	5.1	5.3	13	0.4	0.2
De 75,001 to 100,000	211,422	2.0	1.6	6	0.2	0.0
De 100,001 to 200,000	338,997	3.2	1.1	3	0.1	0.0
Greater than 200,000	25,000	0.2		1	0.0	
Total	10,590,595	100.0	100.0	2,998	100.0	100.0

Source: Agrocapital.

On the other hand, 100 percent of the loans are granted in rural or marginal urban areas, while the distribution according to product line indicates that, of the total portfolio of US$ 10.6 million in 2001, 74.1 percent was assigned to the investment line, and the remaining 25.9 percent to microfinance. This strengthens the assertion that the investment product line is the one that is bringing economies of scale to Agrocapital operations. This line had registered the lowest delinquency rate up to 1998. Clients have greater possibilities of responding positively to external adverse shocks, since they are more diversified, carry out more profitable activities and have greater access to markets. This seems to have been one of the factors involved in Agrocapital's decision to raise its proportion of investment product line from 1999 to 2001, in an adverse economic, political and social context, which negatively affected the Bolivian financial system and the microfinance sector, in particular.

The details of loan allocation by economic sector show that 47 percent of the portfolio was invested in the production sector, a reflection of the great proportion of loans granted to agricultural activities, taking into account the fact that the portfolio is mainly rural. The trade and services sectors were allotted 48 percent, and the remaining 5 percent went to consumption and housing.[15] In the production sector, the main items and products financed were rice, soy, livestock, agricultural machinery purchases, and production infrastructure installation (Table 5.5). This demonstrates that clients are producers with access to relatively stable markets and that their products are non-perishables. Such a high concentration in the portfolio indicates that its diversification according to economic activity can still increase, which would reduce the potential deterioration risks to portfolio quality caused by external shocks.

Table 5.5. Main Products Financed
(December 2001)

Sector (share)	Main products financed
Production (47%)	Rice, soy, agricultural machinery, production infrastructure, livestock, sugar, flower growing, poultry and garden vegetables.
Trade and services (48%)	Trade in general, transport, repair workshops, restaurants, hostels, gas stations and professional services.
Consumption and housing (5%)	Construction, building extensions, home improvements and consumption in general.

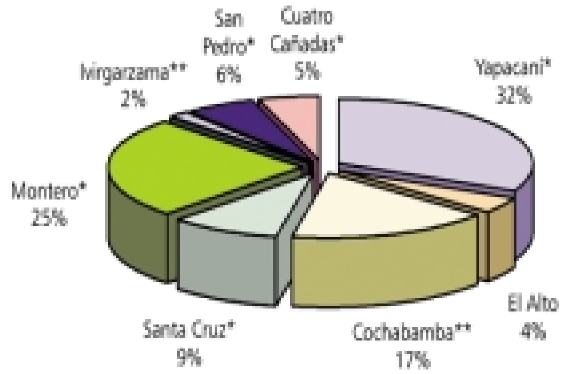
Source: Agrocapital.

Portfolio distribution per Department confirms the assertion that Agrocapital's clients are mainly small agricultural producers located in Bolivia's areas of greatest agricultural development. In fact, as shown in Figure 5.3, a high concentration of the portfolio is in Santa Cruz, where five branches (indicated by asterisks) manage 77.3 percent of the portfolio. Among them, the Yapacaní and Montero branches represent 57.2 percent of the portfolio, 31.9 percent and 25.3 percent, respectively, because of the fact that the demand for investment loans are greater in their areas of operation. Another 18.5 percent of the portfolio is concentrated in the two branches located in the Department of Cochabamba (indicated by double asterisks) and La Paz, where there is only one branch in El Alto, representing 4.2 percent of the portfolio. This pattern of concentration adds risk to Agrocapital's portfolio, which could create problems in the future.[16]

15 This sector had a share of only one percent in 1998. Its growth resulted from the creation of a new microcredit consumer product, *crediconsumo*, in bolivianos and in dollars.

16 In 1998, when the delinquency rate was 3.3 percent, the Montero and Yapacaní branches managed 66 percent of the total portfolio; This concentration was reduced in 2001, but is still high.

Figure 5.3. Portfolio Distribution per Branch, 2001



Source: Agrocapital.

Financial Performance

Operating and Administrative Efficiency[17]

Agrocapital displays respectable levels of operating efficiency, operating costs as a percentage of total assets or portfolio balance, similar to successful cases reported by Christen et al. (1995) and even better than the average of large-scale, Latin American microfinance organizations, whose average portfolio is over US$ 8 million, as reported in the MicroBanking Bulletin (2000). Hence, while organizations such as PRODEM, Caja Los Andes and Bancosol in Bolivia, Financiera Calpiá in El Salvador, and Mibanco in Peru registered a proportion of operating expenditures on the average balance of total assets of 28.1 percent, Agrocapital achieved a rate of 19.4 percent in 1998 (see Table 5.6). Administrative efficiency indicators also showed acceptable results compared to the two reports mentioned above. Specifically, Agrocapital registered a proportion of administrative expenditures/average portfolio balance of 14.2 percent in 1998, while the large-scale Latin American average was 17.3 percent. In 1999, the financial situation of Agrocapital worsened, which is reflected in its lower operating margins and returns.[18]

Operating and Financial Self-Sufficiency

Operating self-sufficiency, measured as the ratio of operating income to operating costs, was also largely achieved in 1998. From the point of view of operating self-sufficiency and profitability (see section 3.2.3), good results have enabled Agrocapital to achieve the less stringent version of financial self-sufficiency (operating income/[non-financial operating costs + financial costs]), but have not been enough for it to reach the strictest version of financial self-sufficiency,(financial income/[non-financial operating

17 It must be added that the cost and income data used to measure self-sufficiency have not been adjusted for subsidies.

18 This situation seems to have worsened in the years that followed.

costs + financial costs]). Increased administrative expenditures for the transformation process into an FFP appear to explain this, as they prevented net income from growing more. Administrative expenditures as a percentage of portfolio balance rose from 1995 to 1998, from 8.5 percent to 13.6 percent, and net profits dropped by an annual average of 5.3 percent. Again, in 1999, operating self-sufficiency was barely achieved, but not financial self-sufficiency.

Profitability[19]

Profitability indicators reached by Agrocapital in 1998 are relatively important and display substantial improvements with respect to 1997 (see Table 5.6), even though the levels registered were significantly lower than in 1995, due to increased spending, especially on fixed assets and staff, and equity registered since 1996 as a result of the start of the formalization process.[20] This was determining in the fact that, in 1998, the 7.6 percent return on equity (ROE) registered was similar to the inflation rate.

In terms of return on assets (ROA), which indicates the organization's performance with respect to all assets (Ledgerwood, 1999), Agrocapital achieved a rate 4.2 percent in 1998, greater than that of Bolivian banks, cooperatives and FFPs, as a result of efficient investment management and high loan recovery rates, despite operating in a context usually more risky and expensive. Finally, the portfolio, which represented 82.4 percent of Agrocapital's assets, produced returns (ROC) of 5.3 percent that year. These indicators deteriorated considerably in 1999, due to a drop of 93 percent in the net profits generated compared to 1998, mainly as a consequence of rising amounts of uncollectable charges of 677 percent (from US$ 108,300 to US$ 840,700)[21] and, second, an increase in administrative expenditures of US$ 227,200.

Solvency

Agrocapital registered an important 57 percent level of solvency in 1998, which indicates that it is under-leveraging in managing its loan portfolio. Such limited exposure to risk (lower leverage), has prevented it from obtaining better returns on equity. Agrocapital had fewer possibilities of generating profits with the funds it receives. It is important to point to out that the leverage level has been markedly reduced since 1994, as a result of a rapid increase in equity; in spite of the fact that funds to lend have increased, they have done so in a smaller proportion. Such difficulties in achieving a greater leverage level probably constitute one of the reasons that led Agrocapital to make the decision to formalize. Again, 1999 represented an inflection point in Agrocapital's performance. The 12.4 percent growth of its gross portfolio was financed by access to greater funds, which involved greater liabilities. Hence, the solvency ratio dropped to 48.2 percent.

19 The return on assets (ROA) was calculated on the balance of assets, not on the average, which presents a methodological difficulty.

20 Due to this, the ROE and the ROA have decreased since 1996. In 1995, the ROA was 9.3 percent and the ROE, 18.7 percent.

21 This was due to an increase in penalties and seizures. On the balance sheet, the portfolio in the process of legal action rose from US$ 187,664 (1.6 percent of the gross portfolio) in 1998 to US$ 674,989 (5.1 percent of the gross portfolio) in 1999.

Table 5.6. Financial Indicators at the End of the Period

Indicator	1997	1998	1999
Operating Efficiency (%)			
Operating costs/ Total assets	16.1	19.4	26.2
Operating costs/ Portfolio balance	19.4	23.6	34.3
Operating income/ Total assets	17.5	23.4	26.3
Operating income/ Portfolio balance	21.1	28.3	34.4
Operating Self-sufficiency (%)			
Operating income/ Operating Costs	114.2	121.5	100.2
Financial Self-sufficiency (%)[a]			
Operating income/ Total costs	108.8	119.3	99.9
Financial income/ Total costs	87.7	90.4	68.5
Profitability (%)			
Net income/ Average equity (ROE)	4.2	7.6	0.5
Net income/ Total assets (ROA)	2.3	4.2	0.3
Net income/ Portfolio average (ROC)	3.1	5.3	0 .4
Solvency (%)			
Adequacy of capital with respect to assets	57.7	57.2	48.2
Delinquency (%)			
Overdue portfolio/ Total portfolio	2.2	3.3	7.8
Overdue portfolio/ Average portfolio balance	2.5	3.4	8.5
Subsidy Dependence Index (SDI)[b]	N. A.	41.7	58.0
Financial subsidy	3.3	5.2	
Capital return subsidy	-4.0	17.7	
Direct subsidies	42.4	35.2	
Productivity (%)			
Average portfolio per loan officer (US$)[c]	553,175	667,186	670,165
Average portfolio per office (US$)[c]	1,044,887	1,134,216	1,206,297
Number of borrowers per loan officer	231	255	251
Number of borrowers per office	436	433	452
Costs (%)			
Average portfolio costs	19.4	23.8	34.4
Average portfolio operating costs	19.4	23.6	34.3
Average portfolio financial costs	1.9	3.2	4.1
Spending structure (%)			
Administrative expenditures/ Total expenditures	65.0	57.1	43.8
Personnel expenditures/ Admin. expenditures	60.5	57.9	58.8
Admin. expenditures/ Average asset balance	11.4	11.8	11.5
Admin. expenditures/ Average portfolio balance	13.6	14.2	15.1

N. A.: not available.

[a] Cost data was adjusted for subsidies.

[b] The SDI was calculated by taking the market's borrowing rate in dollars as the fund opportunity cost (8.32 percent in 1998, and 8.77 percent in 1999) and 6.5 percent as the rate paid in 1998 and 1999 for funds obtained.

[c] The portfolio's average monthly balance was considered.

Source: Agrocapital.

Portfolio Quality

In 1998, Agrocapital registered a very low delinquency rate (more than one day overdue) of 3.25 percent in 1996, and 2.25 percent in 1997, demonstrating that granting individual loans, mostly for fixed investments with long terms, can also be successful in rural areas. These rates are not affected by refinancing, since in 1998 only 0.9 percent of outstanding loans' installment plans were modified. The 1998 delinquency rates were very similar for both product lines.

The low delinquency rate undoubtedly resulted from the use of a technology sufficiently detailed, precise and effective to ensure good client processing and the control of idiosyncratic risk. Furthermore, loans are mainly backed by real guarantees (67 percent of the portfolio in 1998, and 64 percent in 1999). In the technology, a crucial factor in achieving such results has been the management of information, both external (evolution of clients' economic subsector, queries to credit bureaus), as well as informal information collected by loan officers on their visits in the field. The comprehensive knowledge that loan officers have of the areas where they work, as well as the actual incentives they are offered, also played an important role in the client screening process. Despite the above, delinquency rose to 7.8 percent in 1999, as a result of the recession.

Portfolio Management and Liability Structure

An important factor in the case of Agrocapital is the liability structure, since, as opposed to most microfinance organizations, its portfolio is highly concentrated in long-term loans (64.3 percent of the loans had terms over two years in 1998). In order to deal with this term structure, 42.1 percent of the portfolio was financed with the institution's own funds. In addition, long-term liabilities represented 90 percent of total liabilities and 48.2 percent of the portfolio. 90.3 percent of the portfolio was thereby financed with long-term resources. Complementarily, the portfolio payment structure was designed in such a way that there were no problems in complying with Agrocapital's liabilities.

The fact that most loans have a due date over two years away has made Agrocapital more dependent on new financial resources to continue expanding the outreach of its services. Despite this, Agrocapital has managed to increase its portfolio remarkably, thanks to its starting to receive long-term funds with financial cost and at market rates in 1995. Hence, in 1999, 65 percent of liabilities consisted in this type of obligation. In addition, donations have been, since Agrocapital's beginnings, an important source of funds and, in 1998 and 1999, these funds represented 18 percent and 11 percent of total liabilities, respectively.

In the first seven years of Agrocapital's existence, access to increasingly numerous sources of financing and growing returns have ensured the sustained expansion of its totals assets (26 percent), loan portfolio (54 percent), and equity (35 percent).

Subsidies

The indicator used was Yaron's Subsidy Dependence Index (SDI) (1992), which represents the necessary rise in the current interest rate to cover all credit costs and not depend on subsidies. A low SDI therefore indicates lesser dependence on subsidies. The SDI was also decomposed into three types of subsidies: (1) financial subsidies, obtained through loans at concessional rates; (2) capital return subsidies, which measures the difference between the opportunity cost of capital and the net income; and (3) direct subsidies, which are donations to either capital or for operating cost.

As displayed in Table 5.6, Agrocapital is highly dependent on subsidies with 41.7 percent in 1998, which is basically due to the existence of direct subsidies, generated by donated funds, for an amount equivalent to 9.1 percent of its portfolio. However, Agrocapital did not register these donations as income, but as part of its long-term liabilities, which would later become part of its equity under the heading of "Donated funds." These funds have been important for Agrocapital since its creation; so important, in fact, that annual entries are over one million dollars. If such funds were taken out, the SDI registered in 1998 would be -0.7 percent. In 1999, the SDI was 58 percent. That year, although direct subsidies continued to be important sources of funds, they represented 7.6 percent of the portfolio, a significant capital return subsidy was registered (17.7 percent) due to a drastic reduction in net income (mentioned in section 3.2.3). Therefore, even without any direct subsidies, Agrocapital's SDI would still be positive (22.9 percent).

Loan Officer Productivity

Productivity rose in terms of average portfolio per loan officer and per office, as well as in terms of the number of loans per loan officer. In December 1999, an average loan officer oversaw a total of 251 loans and managed a portfolio balance of US$ 670,165, higher figures than in 1997. The average portfolio balance per branch office was over US$ 1,200,000 (see Table 5.6). Given the structure of portfolio and client balances, loan officers in the investment line handled much larger average portfolio amounts like US$ 1,233,000, but smaller numbers of loans like 116, than microfinance loan officers, who managed an average portfolio of US$ 414,545 and 338 loans.

Though this represents a high level of productivity, when taking into account the fact that investment loans required a great deal of work in their monitoring, Agrocapital employees state that this still does not reflect the true potential of loan officers. It would therefore be possible to increase the portfolio without raising salary costs. Finally, due to FFP requirements, Agrocapital has increased its personnel over the past years: had 23 employees in 1992, but by December 1999, that number had risen to 62.

CONCLUSIONS

Agrocapital constitutes one of the most successful experiences in Bolivia's microfinance market and a remarkable example that a Program's outreach can be broadened and good financial results obtained by granting rural, basically agricultural loans mostly over medium and long terms. After seven years in operation, in 1998, Agrocapital had managed to increase its portfolio more than twelvefold and had obtained good results in terms of operating efficiency, self-sufficiency, productivity, profitability and loan recovery in rural areas in the three most important Departments of Bolivia. Nevertheless, in 1999, some of Agrocapital's financial indicators displayed unusual deterioration, due to a steep drop in net income caused by a loss in portfolio quality, in a context of rising operating costs. It must also be pointed out, though, that the entire microfinance system was negatively affected by the economic crisis and by borrowers' expectations about loan rescheduling and write-offs, as the government was giving in to social pressure.

Despite having started out as a directed credit program and having a Board of Directors chosen by international donors organizations, Agrocapital's management evolved very quickly: it abandoned the concept of directed credit and moved on to become an NGO specialized in credit and managed with independence and efficiency.

Agrocapital's experience differs from that of most Bolivian financial NGOs in two aspects: (1) from its beginnings, Agrocapital granted investment loans for relatively high amounts, an average of around US$ 10,000 and (2) always worked with individual loans and individual guarantees. This greater scale enabled Agrocapital to maintain high productivity levels in its loan officers' work and to have relative control over costs.

However, none of Agrocapital's generally good results have sprung up automatically, but has rather been the product of eight years of ongoing learning. In this sense, four key factors may explain Agrocapital's success:

(i) The appropriate selection of loan officers. The thorough knowledge Agrocapital's loan officers have of their areas of operation, as well as the monetary incentives they are offered like high wages and non-monetary incentives like the prestige of the organization, enabled it to reduce information asymmetries and non-compliance risks in its client screening process.

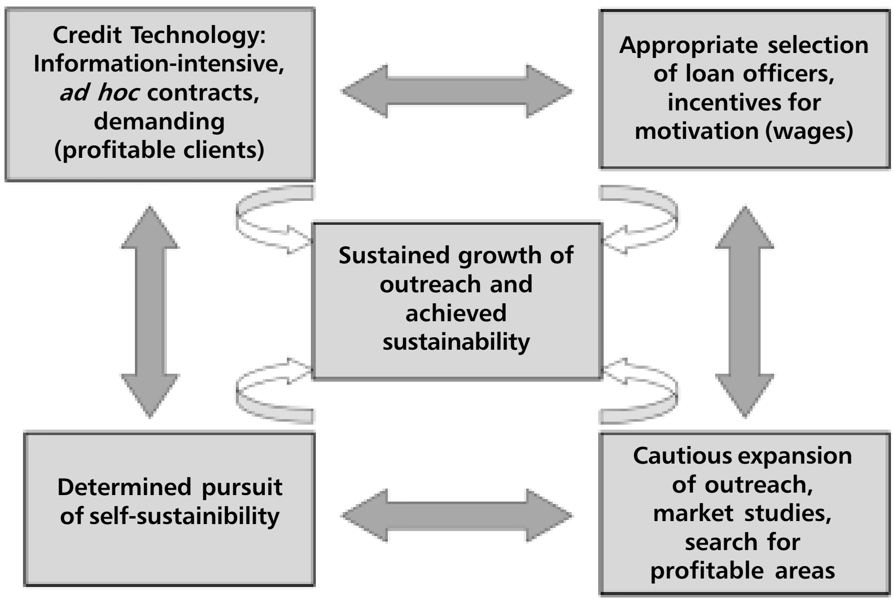
(ii) The cautious expansion of its portfolio, constantly based on prior identification of potential geographic areas, as well as economic sectors and subsectors of influence of established branches. This helped define potential client characteristics, market size, etc. Agrocapital's expansion was thereby based on demand requirements and always directed toward profitable production areas.

(iii) The firm decision to achieve operating sustainability as a part of Agrocapital's philosophy. This meant appropriate liability and credit management.

(iv) The appropriate technology used, which is highly information-intensive, thanks to factors (i) and (ii), and involves achieving sustainability, factor (iii). The constant feedback among the first three elements has allowed Agrocapital to have three distinguished credit features: (1) adaptation to clients' characteristics, (2) meticulous work in client assessment and (3) demanding conditions placed on loan applicants in terms of the productivity and profitability of the project financed.

A few additional comments are required. Agrocapital's lending technology has gradually adapted at the different stages of the organization's existence. As usual, the first years were trial stages for the technology and served to adjust it and consolidate Agrocapital's position on the microfinance market. After eight years, the learning experience acquired enabled Agrocapital to develop a lending technology, particularly, at the screening stage that ensures an exhaustive evaluation of the ability and willingness to pay of loan applicants. In addition, important incentives for loan officers to work efficiently have included relatively high wages and the control exercised by loan supervisors. This combination of factors allowed Agrocapital to achieve low delinquency rates, as well as significant rates of return over the 1995-1998 period, which made its lending technology one of the cornerstones of its success (Figure 5.1).

Figure 5.1. Cornerstones of Agrocapital's Success



Other important components of the lending technology used are listed below.

(i) The close link between loan officers and clients enables them to establish a more direct and dependable relationship and gives loan officers the ability to spot and control opportunistic behavior.

(ii) Loans are not granted to applicants whose residence or business is located too far from Agrocapital branches. This condition aims to facilitate client monitoring, loan recovery and reduce operating costs.

(iii) The terms of the loan contracts, interest rate, loan schedule and installment amounts, are designed according to individual clients' characteristics, taking into account family cash flow, collateral, etc., which ensures the contracts are adapted to clients' seasonal incomes and expenditures.

(iv) Personal or real guarantees are required. Real guarantees are an indispensable requisite for investment loans and must cover at least the value of the loan, in order to reduce the risks of non-payment. In microfinance loans, guarantees are mostly personal, but selecting clients whose dynamic and profitable activities and equity is sufficient to cover at least twice the value of the loan compensates this. This combination of guarantees (solvency) and ability to pay produced good results, since delinquency rates in both lines (investment and microfinance) were similarly low up to 1998, despite an upturn in 1999 that negatively affected earnings and cost indicators.

(v) Finally, but not in order of importance, Agrocapital has a policy of financing every project that is economically and financially profitable. This has provided Agrocapital with clients whose cash flows are high enough to pay their loans and even reduce the risk of non-payment due to external causes, which could affect portfolio.

Challenges and Threats

Even though Agrocapital's imminent transformation into an FFP will help it overcome some of its most severe limitation, that is, reduced funds to continue expanding, the ongoing latent problem of NGO governance represents a significant challenge. Despite the fact that, in becoming an FFP, Agrocapital will also have the right to take deposits, this could generate problems in maintaining a portfolio with a majority share of long-term loans because, in general, savings are short-term obligations (term mismatch). In addition to providing extra financial services, this also implies an additional effort on the staff's part.

Furthermore, transforming into a regulated organization involves stricter requirements regarding information reporting to the Superintendency of Banks. Nonetheless, Agrocapital has been preparing for this change for over three years and has voluntarily been applying Superintendency norms since 1993, portfolio ranking, provisions, etc.

A challenge no least important is portfolio diversification. A large part of Agrocapital's portfolio is concentrated in the agricultural sector, which is extremely vulnerable to external shocks. This means that all the good financial management conducted by the organization may be affected by a negative shock on prices, as occurred in 1998 and 1999, or in production. The economic crisis is also an external event that constitutes a potential threat to clients' ability to pay. Such external shocks took place in 1999 and negatively affected Agrocapital's results.

Other identifiable challenges are the reduction of delinquency rates (even more so after the 1999 results) and, above all, the fact that Agrocapital is consolidating as a sustainable organization independent from subsidies. These objectives turn out to be particularly important when taking into account the fact that, up to now, Agrocapital's expansion has been toward Bolivia's rural areas of greater economic potential and profitability, that is, where less risk is implied; as its outreach grows, it is likely that Agrocapital will have to make incursions into areas of lower profitability where the competition for clients is greater. In the future, additional efforts will therefore be required to maintain and improve efficiency and reduce dependence on subsidies.

Facing these challenges will move Agrocapital toward becoming one of the most promising rural financial organizations in Bolivia and all of Latin America.

Replicability

One of the most important aspects of an experience as unique as that described here is that of its replicability, especially with regards to the investment product line, chiefly directed to agriculture. The success of this product line is based on a series of factors, which are, at the same time, conditions for this experience to be replicated appropriately. One of these essential factors has been the existence of important medium- and large-scale agricultural sectors, which are profitable, technically sophisticated and directly linked to the agroindustry. This characteristic has contributed to having sure and profitable markets for clients' products, which was decisive in the success of this financial product line. Without this feature, it would have been difficult for Agrocapital to achieve the success it now exhibits.

The existence of mid- to long-term financing with high average amounts responded precisely to the characteristics of the market in which Agrocapital operates. Otherwise, it could not provide services to its clients. Furthermore, though it is true that long-term financing requires a payment structure designed to "fit" with the fulfillment of financial obligations, this has not meant that Agrocapital has been problem-free, since it finances its portfolio mostly with its own funds and has taken on long-term obligations.

Another important aspect has been the extensive knowledge that Agrocapital loan officers have of their clients' socioeconomic milieus and financial needs. This represented a solid advantage, which allowed the organization to achieve outstanding results up to 1998.

Finally, land titles have also constituted a necessary component in the sense that they are one of the basic requisites to be considered for long-term loans. Real guarantees, however, do not ensure that the activity to be financed will prove profitable. This must be determined through client assessment, but having land titles can improve access to credit.