

Caja Los Andes (Bolivia) Diversifies into Rural Lending

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Summary

Caja Los Andes (CLA) has distinguished itself as a profitable, diversified provider of individual loans in the highly competitive Bolivian microfinance market. (Caja Los Andes, F.F.P., became Banco Los Andes Procredit in January 2005.) After inheriting a three-year-old urban lending portfolio from its parent organization (Procrédito) in 1995, CLA immediately began to expand its operations to rural areas and add agricultural loans to its portfolio. Despite a difficult recession that began in 1999, CLA has performed well and continues to hold close to 10 percent of its total portfolio in rural and agricultural loans. This case study examines the adaptation of CLA's urban lending methodology for rural and agricultural loans, its risk management techniques for agricultural finance, and the impact of socio-political constraints in Bolivia that limit portfolio growth.

Background

Caja Los Andes (CLA) opened in La Paz, Bolivia in 1995. It was the offspring of Procrédito, a financial NGO founded in Bolivia in 1992 with support from the German consulting firm International Project Consult (IPC). CLA was the first *fondo financiero privado* (private financial fund, or FFP) licensed under then new microfinance regulations. CLA was by no means the first institution on the Bolivian microcredit scene, but it distinguished itself from its competitors by pursuing individual lending, as opposed to solidarity group loans.

Although Procrédito had focused on an urban clientele, CLA immediately began expanding its credit portfolio to include rural enterprises. The urban market for microfinance in Bolivia was becoming saturated, and the failure of state-owned agricultural banks in the 1980s had left enormous swathes of the largely rural country with no access to banking services. CLA hoped that rural expansion would help diversify its portfolio and deepen its mission of improving living standards by providing financial services to the poor.

Challenges of Rural Lending

With its expansion into rural Bolivia, Caja Los Andes faced a spectrum of challenges familiar to MFIs around the world that have attempted agricultural finance.

Higher Cost of Reaching Rural Clients

CLA took a number of steps to minimize the costs associated with the physical distance between rural clients. It strategically selected the locations of its rural offices, focusing on small town hubs in more densely populated rural regions, and favored areas that had good irrigation systems and a sound base of crops with well-established markets.¹ These rural offices do not lend exclusively to rural clients, so the lower cost of lending to clients in town, combined with the slightly higher interest rates charged for agricultural loans, helps cover the expense of lending to clients in more isolated areas. The cautious provision of some consumer credit to salaried employees also helps offset agricultural lending expenses.

¹ CLA established its first rural office in 1996 in Punata, a small town in the relatively well-populated agricultural department of Cochabamba. See Buchenau, "Financing Small Farmers in Latin America," 1997.

In keeping with its individual lending methodology in urban areas, CLA makes larger first loans to agricultural clients if warranted. It bases loan sizes on repayment capacity rather than a stepped approach, in which borrowers establish a credit history by starting with smaller loans and working their way up. CLA also moves up-market with its clients, making increasingly larger and longer-term loans as their enterprises grow. These practices boost efficiency and balance the agricultural portfolio, allowing CLA to continue reaching out to new, lower-income borrowers.

Mitigation of General Agricultural Risk

Bolivia has a natural advantage for the diversification of agricultural risk: an array of altitudes and microclimates, even within small areas, that helps protect against widespread crop losses. CLA institutionalizes and builds on these natural advantages by focusing its services on clients who diversify their own risk, either through the cultivation of multiple crops, planting in several locations, and/or combining dairy farming, livestock, or other income-generating activities with crop production.² Borrowers with more diversified enterprises may access larger loan amounts than farmers relying on fewer income sources.

CLA worked with IPC to develop a lending technology that treats the various activities of a rural family as a single socioeconomic unit and accounts for all cash flows of a multi-faceted rural enterprise. This approach helps the institution maintain a high repayment rate on its agricultural portfolio.

Adaptation of Loan Products to Meet Rural Needs

CLA and Procrédito adapted existing policies on collateral, appraisal, disbursement and repayments to meet rural conditions:

- **Collateral:** Many potential rural clients did not possess sufficient assets or even registered land titles. Bolivian law, moreover, prevented many small farmers from using their land as collateral.³ CLA already used a flexible approach to collateral though, that focused on the value of pledged assets to the *borrower*, rather than the recovery value for the lender. Rural loans under US \$7,500 are collateralized with farm or household assets, and non-registered land titles may be deposited with

CLA as collateral for up to 50 percent of the value of a loan.

- **Appraisal, disbursement, and repayment:** Disbursements can be made in installments corresponding to the crop cycle, and payments are set according to revenue flows. Several disbursement and repayment plans are offered, depending upon the needs and risk level of the borrower, including:
 1. single disbursement with a single lump sum payment of capital and interest at the end of the term;
 2. single disbursement followed by periodic repayments with two variations (fully amortized with periodic payments in equal amounts, or partially amortized with periodic interest payments and a balloon payment at the end of the term);
 3. two or three periodic disbursements with one final capital and interest payment at the end of the term; and
 4. different, irregular disbursements and repayments tailored to the cash flow schedule of the individual enterprise.

Managing Borrower-Specific Risk in a More Complex Environment

All of CLA's rural loan officers have degrees in agriculture and/or backgrounds in agronomy, plus significant experience living in the local area. These qualifications ensure that staff has thorough knowledge of agricultural inputs, risks and business models, as well as local culture and indigenous languages. Loan officer training in lending methodology and credit analysis is followed by approximately one year of on-the-job training under the close supervision of a branch manager.

CLA also takes a hard stance on repayment. One of the institution's abiding challenges is to change rural borrowers' perceptions and habits regarding financial services because many farmers' previous experience with credit involved unsustainable rates and terms, and ready loan forgiveness. CLA thus made a point of establishing a reputation for not tolerating delinquency. Loan officers visit clients immediately after the first missed payment, in part to help address any business problem before the damage multiplies. Penalty interest rates are charged to delinquent clients, while reduced interest rates are offered to repeat clients in good standing.

² Most rural families in Bolivia engage in two-to-five different income-generating activities, as compared to urban citizens, who typically have only one or two income sources. See Buchenau, "Financing Small Farmers," 1997.

³ Bolivian land reform laws are intended to protect poor farmers from land seizure by predatory lenders.

Quick Turnaround Times

CLA emphasizes a rapid application and disbursement process. Staff use sophisticated computer software to develop balance sheets and cash flow statements for efficient, systematic analysis. Approvals are decentralized, with branch managers responsible for loans of up to US \$5,000, and regional directors, up to \$20,000. Staff remuneration is tied to the size, number and quality of officers' loans, providing an incentive to process loans quickly and accurately.⁴ The process takes an average of three to seven days; repeat borrowers enjoy faster service.

Seven Years of Rural Lending

Between 1995 and 2002, CLA's loan portfolio grew at an average annual rate of more than 40 percent. By 2002, the organization had 477 employees operating through 27 branches in six (of nine) regions, offering a variety of both urban and rural financial products. The MFI's primary products were individual loans and savings deposits for micro-, small- and medium-sized enterprises. Loans typically carried interest rates of 1.3 percent to 2.5 percent per month for US dollar denominations (up to 3.5 percent per month for disbursements in Bolivianos), with terms of up to five years. CLA also offered time deposits, credit lines to proven customers, letters of guarantee, urban housing renovation loans, consumer credit to salaried workers, and gold-based pawn loans.

At the end of 2002, CLA had a total outstanding credit portfolio worth US \$64.2 million,⁵ comprised of 51,000 loans to 47,000 clients. Its portfolio alone represented 26 percent of the outstanding loan portfolio of the regulated microfinance sector in Bolivia in 2002. The institution's savings deposits were valued at \$34.6 million and comprised about 30,000 accounts. Loans ranged in size from under \$500 (21 percent of loans) to \$200,000, with an average loan size of \$1,250. Around 20 percent of agricultural loans were for longer-term investments (up to \$30,000 per loan), such as tractors (up to \$30,000), trucks (up to \$25,000), cowsheds (up to \$3,000) and milking equipment (up to \$4,000).

Loans to rural clients, which included agricultural credit as well as rural enterprises, accounted for 9 percent of overall portfolio volume and 15.3 percent in terms of number of loans. Agricultural credit alone comprised 6 percent of

CLA's overall portfolio in 2002, approximately 12 percent in terms of numbers of loans, and carried an elevated portfolio at risk greater than 30 days (PAR > 30) of 8.26 percent; as compared to 7 percent for the portfolio as a whole. In 2003, agricultural lending declined 4 percent of portfolio volume, about 10 percent of the number of loans, with an improved PAR > 30 of 3.4 percent. The institution was finally self-sufficient, and its return on equity I 2002 and 2003 was over 20 percent. (See table 1 for additional information.)

In spite of regional financial instability starting in the mid-1990s and a Bolivian recession that began in 1999, Caja Los Andes and the regulated Bolivian microfinance industry as a whole continued to flourish through 2003. Those institutions with a substantial rural portfolio fared noticeably better than their exclusively urban counterparts.⁶ While political uncertainty and borrower protests in urban areas contributed to a significant decline in the country's formal banking sector, the FFPs managed to nearly double their portfolios, lower their arrears rates and—although modest compared to previous years—maintain profitability.⁷

During this volatile economic period, CLA gradually increased its rural lending (averaging between 15 and 17.5 percent of overall portfolio between 1999 and 2002), which served to balance CLA's portfolio and allowed it to continue growing, despite widespread defaults in the microfinance industry in 2000. The value of the rural portfolio during the downturn reinforced CLA's commitment to maintaining a well-diversified, urban-rural portfolio. Rural lending volume peaked in mid-2001 and then declined as loan sizes began to decrease (see table 3). Over the course of 2003, agricultural PAR > 30 was restored to the approximate level of the portfolio as a whole, 3.4 percent (compared to 3.1 percent overall), but the agricultural portfolio declined to 4 percent of total loan activity (see table 4 below).

Donors and Investors

Over the course of its development, CLA and Procrédito have received technical assistance from IPC (funded by Gesellschaft für Technische Zusammenarbeit, or GTZ); the multilateral financial institution Corporación Andina de Fomento; the

⁴ FAO, *Term Financing In Agriculture*, 2003.

⁵ All monetary figures are given in US dollars unless otherwise noted.

⁶ Based on 2001 Bolivia statistics from the MIX Market (www.themixmbb.org); and Buchenau, "Products in the Process of Commercialization," 2001.

⁷ Von Stauffenberg, "How Microfinance Evolves," 2001; Caja Los Andes, *Annual Report 2002*.

Table 1 Financial indicators of Caja Los Andes, 2000–2003

| Item | 2000 | 2001 | 2002 | 2003 ^a |
|--|------------|-------------------|-------------------|-------------------|
| Outreach | | | | |
| Outstanding gross portfolio (US\$) | 46,759,853 | 52,633,750 | 64,219,989 | 82,179,376 |
| Number of outstanding loans | 44,180 | 46,605 | 51,073 | 53,213 |
| Average outstanding loan size (US\$) | 1,058 | 1,129 | 1,257 | 1,544 |
| Average loan size as % of GDP/per capita | 105% | 121% | 143% | 164% |
| Total savings deposits (US\$) | 13,920,534 | 21,719,87 | 34,550,321 | 49,100,000 |
| Number of saving accounts | 18,589 | 23,308 | 29,701 | NA |
| Average deposit balance (US\$) | 749 | 932 | 1,163 | NA |
| Sustainability/Profitability | | | | |
| Return on Assets (%) | 1.4% | 1.5% | 1.6% | 2.1% |
| Return on Equity (%) | 13.6% | 11.5% | 20.1% | 25.5% |
| Operational self-sufficiency (%) | 1.55% | 1.49% | 1.40% | NA |
| Financial self-sufficiency (%) | 1.07% | 1.07% | 1.08% | NA |
| Operational efficiency | | | | |
| Operating expense ratio (expenses/average portfolio) | 12.15% | 13.02% | 12.46% | NA |
| Loan officer productivity (clients per loan officer) | 379 | 366 | 326 | NA |
| Portfolio quality | | | | |
| PAR > 30 days | 5.1% | 6.3% | 4.8% | 3.1% |
| Exchange rate (Bolivianos/US\$): | | 6.81 ^b | 7.48 ^c | |

Sources: Caja Los Andes Annual Report; CGAP consultant visit, 2003; Caja Los Andes internal reports.

Notes: ^a Unaudited financials. ^b CLA, 2003, *Annual Report 2002*. ^c Unaudited financials, December 2003.

Table 2 Evolution of CLA Rural Loan Portfolio, 1996–2002

| | 1996 | 1997 | 1998 | 1999 | 2000* | 2001* | 2002* |
|--------------------------------|------------|------------|------------|------------|------------|------------|------------|
| Total CLA loans | 23,905 | 29,545 | 34,838 | 39,335 | 44,180 | 46,605 | 51,073 |
| No. of rural loans | 906 | 1,285 | 3,312 | 5,817 | 7,770 | 7,136 | 7,833 |
| % Rural | 3.8% | 4.3% | 9.5% | 14.8% | 17.6% | 15.3% | 15.3% |
| Gross CLA portfolio (US\$) | 11,899,908 | 20,459,135 | 28,613,915 | 35,852,453 | 46,897,140 | 54,912,371 | 66,386,519 |
| Rural portfolio (US\$) | 386,586 | 740,027 | 2,547,420 | 5,073,053 | 7,103,379 | 6,337,044 | 6,132,715 |
| % Rural | 3.2% | 3.6% | 8.9% | 14.1% | 15.2% | 12.0% | 9.5% |
| Average rural loan size (US\$) | 427 | 576 | 769 | 872 | 914 | 888 | 783 |

Source: FAO, 2003.

* Gross portfolio figures for 2000-02 are from the Mix Market.

Table 3 Agricultural Loan Portfolio 2000–03

| | 2000 | 2001 | 2002 | 2003 (unaudited financials) |
|---------------------------------|-----------|-----------|-----------|--------------------------------|
| Outreach | | | | |
| Active portfolio (US\$) | 4,333,280 | 4,258,519 | 3,884,503 | 3,432,856 |
| Share of total active portfolio | 9% | 8% | 6% | 4% |
| Growth from prior year | NA | -2% | -9% | -12% |
| Number of loans outstanding | NA | 5,755 | 5,815 | 5,006 |
| Average loan size (US\$) | NA | 740 | 668 | 686 |
| Portfolio quality | | | | |
| PAR > 30 days as % of portfolio | 6.29% | 10.15% | 8.26% | 3.40% |

Source: Caja Los Andes, 2003 unaudited data, Annual Report 2002, and CGAP consultant visit, 2003.

Multilateral Investment Fund of the Inter-American Development Bank, plus financing from an array of international and Bolivian investors.

IPC played an integral role in helping CLA adapt Procrédito's urban lending methodology to serve an agricultural market and become a self-sustaining institution. Its technical assistance included help in establishing financing relationships, conducting feasibility studies, arranging extended learning visits to Calpiá in El Salvador, and conducting staff training. The long-term perspective of IPC and other donors, plus the combination of technical and financial support extended to CLA, contributed to its success. Finally, the commitment of CLA board members and managers to the rural portfolio helped the institution weather difficult times.

Lessons Learned

The following lessons can also be drawn from Caja Los Andes' experience in agricultural microfinance:

- Agricultural loans can be sustainable—even profitable—if combined with other types of rural and urban financing.
- When first expanding into rural areas, it can be effective to initiate operations in more populous, lower-risk, and high-opportunity regions before expanding to more challenging areas.
- Agricultural portfolio risk can be mitigated by targeting borrowers engaged in diversified economic activities.
- Loans to rural enterprises should be awarded on the basis of all agricultural and non-agricultural income streams.

- Loan structure and repayment schedules should be tailored to fit the inherent seasonality of many rural enterprises.
- Diversification through agricultural lending can help preserve an MFI's profitability during economic recession.
- Political instability poses a grave threat to agricultural *and* urban, microfinance, particularly when appeals to the masses by political candidates create incentives to default. When lending in an area contaminated by past agricultural debt forgiveness, a particularly strict approach to late and non-payments is required, but may not be sufficient to ensure high portfolio quality.

Conclusion

The experience of Caja Los Andes illustrates both the potential and the limits of expanding microfinance operations into rural contexts and agricultural activities. While the CLA portfolio in agriculture is well managed, sustainable, and significant in terms of volume and clientele, it now represents less than 10 percent of CLA's overall portfolio. The weight of agricultural lending in the portfolio is similar in other applications of the IPC model (15 percent of the gross portfolio at Calpiá in El Salvador, for example). Poorer clients in remoter areas are also not served in the initial stages of expansion into agricultural lending at least, with branches opened in rural population centres for clients with diverse income sources.

CLA's diminished agricultural portfolio over the past few years can be traced to high delinquency rates in two rural offices, and to a broader

undercurrent of political instability in Bolivia. Civil unrest, increased protectionist policies and ongoing pressure from interest groups seeking government-mandated loan forgiveness for farmers have necessitated a scaling back of rural and agricultural lending in recent years. CLA's overall institutional

performance has remained strong and continues to grow, making up for diminished loan values and the higher delinquencies of the agricultural portfolio. Nevertheless, political instability is putting at risk the long-term sustainability of CLA's agricultural portfolio.

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FINANCIAL INDICATORS DEFINITIONS TABLE

Outstanding gross portfolio—the outstanding principal balance of all of the MFI's outstanding loans including current, delinquent, and restructured loans, but not loans that have been written off.

Number of active borrowers—the number of individuals who currently have an outstanding loan balance with the MFI or are responsible for repaying any portion of the gross loan portfolio.

Average loan balance per borrower—the outstanding gross portfolio divided by the number of active borrowers.

Average loan balance as percent of GNI per capita—average loan balance per borrower divided by the country's World Bank-published gross national income per capita.

Total savings deposits—the total value of funds placed in an account with the MFI that is payable on demand to the depositor. This item includes any current, checking, or savings accounts that are payable on demand. It also includes time deposits, which have a fixed maturity date.

Number of savings accounts—the total number of deposit accounts at the MFI, as a proxy for the number of depositing individuals that the MFI is liable to repay. This number applies only to deposits that are held by the MFI, not to those deposits held in other institutions by the MFI's clients. The number is based on individuals rather than the number of groups. It is possible that a single deposit account may represent multiple depositors.

Average deposit balance—total savings deposits divided by number of savings accounts, as a proxy for average client savings.

Portfolio at risk (PAR > 30 days)—the value of all loans outstanding that have one or more installments of principal past due more than 30 days. This item includes the entire unpaid principal balance, including both the past due and future installments, but not accrued interest. It also does not include loans that have been restructured or rescheduled.

| | | |
|------------------------------|---|--|
| Return on assets (ROA) | $\frac{\text{Net operating income plus taxes}}{\text{Average assets}}$ | Measures how well the MFI uses its total assets to generate returns |
| Return on equity (ROE) | $\frac{\text{Net operating income less taxes}}{\text{Average equity}}$ | Calculates the rate of return on the average equity for the period |
| Operational self-sufficiency | $\frac{\text{Operating revenue}}{\text{Financial expense plus Loan loss provision expense plus Operating expense}}$ | Measures how well an MFI can cover its costs through operating revenues. In addition to operating expenses, it is recommended that financial expense and loan loss provision expenses be included in this calculation as they are a normal (and significant) cost of operating |
| Financial self-sufficiency | $\frac{\text{Adjusted operating revenue}}{\text{Financial expense plus Loan loss provision expense plus Adjusted operating expense}}$ | Measures how well an MFI can cover its costs taking into account a number of adjustments to operating revenues and expenses. The purpose of most of these adjustments is to model how well the MFI could cover its costs if its operations were unsubsidized and it were funding its expansion with commercial-cost liabilities. |
| Operating expense ratio | $\frac{\text{Operating expense}}{\text{Average gross loan portfolio}}$ | Includes all administrative and personnel expense, and is the most commonly used efficiency indicator |
| Loan officer productivity | $\frac{\text{Number of active borrowers}}{\text{Number of loan officers}}$ | Measures the average caseload of each loan officer |