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The Impact of Regulatory Framework on Microfinance Institutions' Performance: Focusing on a comparison between Bolivia and Colombia

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The Impact of Regulatory Framework on Microfinance Institutions' Performance: Focusing on a comparison between Bolivia and Colombia

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Abstract

The Impact of Regulatory Framework on Microfinance Institutions' Performance: Focusing on a comparison between Bolivia and Colombia

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The aim of this paper is to investigate the regulatory environment of microfinance industry, specifically focusing on a comparison of two Latin American Countries which are Bolivia and Colombia. After the advent of microfinance from the 1970s with the funding and technical assistance from the United States, the role of Microfinance Institutions (MFIs) has been emphasized as a development tool to combat extreme poverty by providing micro-financial products to small borrowers who have been marginalized from traditional banking services.

In case of Bolivia, the regulatory and supervision environment targeting its specialized MFIs is highly advanced and a lot of Bolivians have benefited from the micro-financial services whereas Colombia has showed low maturity level in terms of their regulated and specialized MFIs. This thesis highlights the government's approach on microfinance sector in these two countries and figures out the differences.

Through a comparative analysis between Bolivia and Colombia, this thesis ultimately aims at finding out how the introduction of financial liberalization factors and appropriate regulation framework for MFIs has affected the development of microfinance industry in each country. In the end, this study shows how the creation of an adequate regulatory framework is critical in creating a favorable environment to make it easier for NGOs to become regulated financial intermediaries. For this, specific case studies of Bolivia and Colombia are covered and its analysis is fundamentally based on the theory of Historical Institutionalism (HI) which considers institutions as a means of retracing sequences of social, political and economic changes over time.

Keywords: Microfinance, Official Development Assistance (ODA), Regulatory Environment, Latin America, Poverty Reduction, Non-Governmental Organizations (NGOs)

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I. Introduction

According to Otero(1999), Microfinance refers to the supply of financial services to low income class and self-employed people. More specifically, here, the financial services don’t only involve credit but also encompass savings, insurance and payment services, etc. In a more social aspect of microfinance, Schreiner and Colombet (2001) described it as an attempt to enhance the poor households’ financial accessibility to small loans and deposits since most of the low income people have been excluded from traditional banking services. The international community had begun to recognize a chronic shortage of the poorest of the poor, which is closed approach to financial services.

With the advent of Bangladesh’s Grameen Bank in 1983, microfinance has emerged as an effective and innovative solution to eradicate extreme poverty by supporting self-reliance of the poor. Even though there has been controversy on the effectiveness of it, the need for microfinance is still apparent and many of the low-income people have benefited from micro-financial services in their daily life. When it comes to the factors contributing to successful management of microfinance institutions, various elements are suggested such as focusing on the unbanked segment, adopting new technologies, and diversifying their products and services. Among these various factors accelerating the growth of microfinance, this paper will focus on the correlation between appropriate regulation framework for microfinance and its impact on the microfinance institutions’ performance. Since whether the regulatory specific to microfinance has established or not, and the government's approach to the sector was supportive or restrictive is crucial factor that determine the growth of microfinance industry in a country, this study will adopt the regulation framework as a key criteria of analysis. In this context, this paper aims to analyze the regulatory framework of microfinance sector especially focusing on the comparison of two countries which are Bolivia and Colombia.

In case of Bolivia, microfinance industry has developed significantly and a lot of people have benefited from microfinance institutions. Above all, the operation of microfinance institutions in the country has proved its operation ability and transparency. On the other hand, in case of Colombia, microfinance sector hasn't produced satisfactory results compared to the potentials the country has. This paper looks into the differences of regulatory framework and microfinance environment of these two countries and finally assumes that appropriate regulation for microfinance itself is a crucial key to the growth of microfinance in a country.

Since this comparative analysis begins with the assumption that microfinance is helpful for alleviating poverty, and moreover it gives a chance to minority groups such as micro-entrepreneurs and women, this paper will review first about the need for microfinance. And then details of regulation and general introduction of microfinance in Latin America also will be covered. Subsequently, comparison on regulatory framework and environment of microfinance sector in Bolivia and Colombia will be analyzed specifically.

II. Literature Review

1. Microfinance in Official Development Assistance (ODA)

Microfinance benefited from widespread international recognition as a development tool. It was promoted by many national governments which have been desirable for bridging the financial inclusion gap, and it became one of the agendas of the United Nations and G8 [1]. Before the comparatively new concept "Microfinance" in the field of Official Development Assistance (ODA) appears in the 1970s, the supply of financial services to the poor households was mainly given by international aid through subsidized rural credit programs. However, the dependent assistance from an external capital frequently caused high loan defaults and showed limits in its reaching to rural areas (Robinson, 2001).

Throughout the 1980s, as Grameen Bank and BRI (Bank Raykat Indonesia) played a preeminent role in providing small loans and saving services in a large scale not receiving continuous financial assistance from other external agencies, a turning point started. Above all, they became commercially funded, financially self-sustainable and could have a wider outreach to clients. According to Dichter (1999), the 1990s is defined as "the microfinance decade". In this decade, there was an accelerated growth in regard to the number of microfinance institutions and active clients. In accordance with the development of microfinance institutions, main

[1] Greg Chen, Stephen Rasmussen and Xavier Reille. 2010. "Growth and Vulnerabilities in Microfinance." CGAP. p.1

focus has shifted from only putting emphasis on the provisions of micro-credit to more diverse types of financial services such as deposit-taking, insurance and pension, as it became evident that the poorest of the poor also had a big demand for the use of various financial services.

The Microfinance Institutions (MFIs) that provide financial services which are adapted to the need of low-income people have essentially different aspects from conventional banks. Namely, there is a substantial difference between a microfinance provider and a bank. The major different aspects between the two can be summarized as below.

[Table 1. Comparison of bank and MFI]

Category	Commercial bank	Microfinance Institutions
Focus	Profitability and Market Share	Sustainable credit system for financially marginalized people
Customer Service Mode	Customer access branches	MFIs access customer at the location of their inhabitation
Source of Funds	Combination of owned and Borrowed Capital	MFIs operated on Borrowed fund
Cost of Operation	Mechanism that crosses subsidies operating cost of several sets of services and products	The quality of customer contact is the key to the high repayment rate
Mutual Interest	Banks are interested in MFIs because such credit lines enable	Ownership of MFIs lies with the development

	banks to achieve the 'priority sector' obligation	professionals and social investor who invest with social objectives
Financial Goal	Profit maximization	Surplus to sustain

Source: Shastri, R. K. (2009). Micro finance and poverty reduction in India (A comparative study with Asian Countries). *African journal of business management*, *3*(4), 136.

2. Perspectives on Microfinance

According to United Nations Capital Development Fund (UNCDF), microfinance carries out three key roles as follows. First of all, it makes very low-income households fulfill their basic needs. Secondly, it is related to improvements in household economic welfare. Lastly, it fosters the empowerment of women by supporting their economic participation and moreover, it enhances gender equality by making women also as main agents of economic activity. Even though the importance of microfinance has been highlighted over the past few decades like this, there also appeared negative perspectives about the effectiveness of it.

Most scholars who have negative view about microfinance commonly point out that it is not necessarily a panacea for poverty alleviation[2]. In this light, Wright (2000) states that microfinance addresses the symptoms of poverty, not the actual root of the problem and then a lot of microfinance projects were not able to reach the real poorest. As a result, it has had a limited effect on increasing real income of the clients. Furthermore, they indicate that international donors and governmental agencies should consider whether the very poor people can benefit more from micro-financial services, than from visible ways such as assistance of health care and food supply.

Since poverty is more than just a lack of income, Wright (1999) also highlights the shortcomings of focusing solely on increased incomes as a way of measuring the impact of microfinance on poverty reduction. According to him, there is a substantial distinction between an increase of earnings and decrease of poverty. For example, if the money is used in a wrong way such as drinking alcohol, it's not easy to say that the increased amount of income was practically meaningful for the poor. Therefore, the priority should be what the poor do with the money, namely, its main focus should be on creating an environment where their clients can sustain a specified level of well-being by receiving various financial services which are tailored to their needs. By doing so, the overall economic security can be improved ultimately.

[2] Nicholas Franco, 2011, "Does Microfinance Reduce Poverty? A Study of Latin America", Boston College, p.40

As seen above, even though there has been skepticism about the impact of MFIs on poverty reduction effects, a lot of studies have also proved that microfinance has worked effectively in a variety of situations. These studies have clearly shown that in case of well-designed programs and institutions, they could improve the incomes and level of living of the poor in their daily life and also suggested that low-income people were ultimately encouraged to escape from chronic poverty trap by receiving financial support from MFIs. In addition, Mayousx (2001) argued that microfinance has demonstrated its potential in playing a significant role to increase incomes of the better-off poor, including women.

Above all things, the poor could have increase ability in coping with unpredictable economic shocks and emergencies with the financial services of MFIs. More specifically, here, some meaningful changes in the perspective of scholars on the microfinance sector can be found. That is, microfinance specialists began to regard improvements in economic security as the priority step in eradicating poverty, rather than visible increasing of income amount itself. A series of researches verified positive impact of MFIs and then suggested the reason why financial services which are especially designed for the poor are needed, and it can be summarized as follows.

[Table 2. World Economic Forum Agenda on Microfinance (2015)]

1. MFIs provide the gradual approach for combating extreme poverty
Once clients complete the program and no problems in complying in repayment and other conditions. Then, MFI helps to sustain the client's next plan in receiving financial services
2. MFIs can boost agriculture and promote food security
Smallholder famers are given tailored financial services through investment in new techniques, high quality seeds and fertilizers from the provision of agricultural financial services
3. MFIs offer access to health care
Financial service providers have come up with innovative financing mechanisms that promote healthcare that have shown increasing evidence of positive impact
4. MFIs promote gender equality
Lending to women through small groups has increased their sense of empowerment within households and communities
5. MFIs promote inclusive economic growth and stimulates productive employment for the poor
In Latin America, microfinance has given millions of rural women, used to engage in domestic work, the chance to earn independently through the micro-business they establish

Source: https://www.weforum.org/agenda/2015/09/5-reasons-why-we-need-financial-services-for-the-poor/

3. Regulation on Microfinance

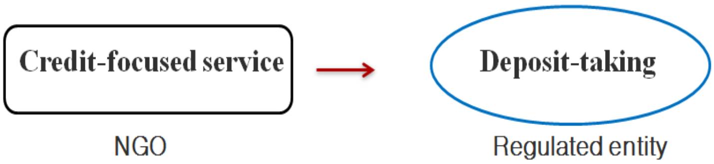
Along with the growth of microfinance sector in the world, there has formed a broad consensus that the regulation and supervision of microfinance is a crucially important factor which decides the success and further development of it. However, constructing an appropriate regulatory framework, which is specialized for MFIs is not that simple due to the complexity of the industry itself. As highlighted, microfinance has a lot of different aspects from conventional banking system, namely, the essential nature of microfinance is distinct from traditional banks such as clients and types of services, etc. As a result, "one-size-fits-all" solution is neither possible nor desirable for the development of microfinance[3].

In other words, regulatory and supervisory framework for microfinance should be adjusting to make balance the need for financial stability, integrity, effective operation and consumer protection with the need to preserve innovation and healthy competition to offer diverse financial services for the low-income people. According to Anne Pouchous (2012), as the more microfinance sector matures, the more arguments put emphasis on proper regulation framework and oversight of the industry. She also mentions that by establishing appropriate regulation which is tailored to the characteristics of microfinance, MFIs can cope with unpredicted situations, and the following aspects can be dealt with timely: (i) the protection of the country's financial system and small depositors, (ii) addressing the

[3] Hennie van Greuning, Joselito Gallardo and Bikki Randhawa. 1998. "A Framework for Regulating Microfinance Institutions". The World Bank Financial Sector Development Department

consequences of rapid growth and fast commercialization of the microfinance sector, (iii) consumer protection and the fight against abusive interest rates, (iv) the entry of new providers and credit delivery mechanisms, (v) fraud and financial crimes prevention[4].

[Table 3. Changes from a NGO to a regulated MFI]



Source: Produced by the Author

Above all, transforming a MFI which used to deliver credit-focused service into a microfinance institution that covers deposit-taking function is substantially important to make the MFI sustainable and better meet the expanded needs of clients. By joining the financial system through being regulated and supervised financial intermediaries, MFIs can reduce donor dependence and it can finally become self-sustainable. Therefore, many MFIs intend to convert themselves into deposit-taking financial intermediaries and by doing so, try to enlarge their services including pension, insurance and other types of financial services.

However, deposit-taking has no choice but to accompany any possibilities of

[4] Anne Pouchous. 2012. "The Regulation and Supervision of Microfinance: Main issues and progress." Report of the International Institute for Sustainable Development. p.3

risk. To be specific, MFIs need to lend profitably enough to pay for and protect the deposits they want to mobilize, and they should come up with temporary downturns. As MFIs hold limits in using cash as collateral and default payments are inclined to be contagious in a short time when they appear, the ability of actively coping with the changing financial circumstances of microfinance institutions is more emphasized than before. Thus, regulatory framework which comprehends fully this specialized aspect of MFIs is essential to protect financial system and small depositors of a country.

Secondly, regulation in Microfinance is needed to handle a series of outcomes of rapid growth and fast commercialization of the microfinance sector. After its advent in the 1970s by Professor Muhammad Yunus, as more MFIs that developed quantitatively as well as qualitatively started to bring external money not just focusing on donor and government. Thus, many MFIs had experienced rapid commercialization. Anne Pouchous (2012) indicated that even though this playing along market rules has made the MFIs more financially independent from new resources of funding, a greater outreach for proper returns for investors, this situation also made MFIs committed themselves to corporate investors and began to be far away from primary objectives such as pro-poor outreach and poverty reduction.

As a consequence of intense profit-seeking behavior based on weak governance, overstretched systems and controls, a lot of recently transformed MFIs have considerably overlooked credit discipline, which ten translated into serious loan delinquency problems at a rapid pace[5]. Due to this excessive pursuit of profit, many borrowers received credit services which were not fit to their needs and beyond their repayment capacity. Thus, a distorted loan habit of consumer was intensified.

As competition among MFIs becomes more intensified, new entries to the market started to disregard the original credit delivery technologies that were stably constructed by microfinance institutions at its early stage, such as group lending, village banking and compulsory saving techniques. As examined before, even though competitions is considered to be a positive factor to make MFI market healthy and competitive, it was particularly too past in the microfinance sector. As a result, a suitable regulation and oversight of microfinance became more crucial to make balance and control some of these excesses. Lastly, concerns about consumer protection and interest rates increase the need for proper regulation framework for microfinance.

[5] Anne Pouchous. 2012. “The Regulation and Supervision of Microfinance: Main issues and progress”. p. 4

4. Consumer Protection in Microfinance

In terms of consumer protection, negative consequences which were caused by peer pressure mechanism used to form the basis of many microfinance programs, frequently caused abuses such as privacy threaten and social exclusion and this even become worse with the problem of misleading contractual information. With the aforementioned problems of consumer protection, the fight against abusive interest rates also appeared as an essential element of successful operation of MFIs. In other words, the delivery of comparable and transparent information about interest rate becomes controversial issues among regulators and professionals of microfinance.

While many regulators assume that interest rate ceiling is an effective means of preventing abusive rates and foster price transparency, most microfinance experts think differently. They assume that policy-makers will not be able to set an interest rate cap high enough to permit the development of sustainable microcredit, which in turn would imperil financial inclusion services to the poor[6]. In addition, according to Koenigsfest (2008), it's clear that the leaders of microfinance industry agree that the government should refrain from intervening directly, especially if the intervention involves subsidized credit or caps on interest rates. As such, mandatory interest ceilings have been a significantly controversial issue in this sector.

[6] Brigit Helms and Xavier Reille. 2004. "Interest rate ceilings and Microfinance: The story so far". p.14

Unlike the original purpose of governmental authorities that capping interest rates in micro-financial services as part of protecting consumers, interest rate ceiling is not an effective way to protect poor clients. Interest rate ceilings usually affect adversely by making it difficult for new MFIs to enter the market. And in some countries with the mandatory interest rate controls, MFIs frequently take away from the market by gradually withdrawing their services in rural areas and demonstrate slow growth speed and less transparency about total loan costs. Like this, by forcing pro-poor financial institutions out of business, interest rate caps often drive clients back to the expensive informal market where they have no or little protection[7]. To say again, to protect consumer protection and sustain interest rate stably, the government's more careful approach which fosters healthy and active competition among the entries to the market rather than compulsory controlling the industry.

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[7] Eric Duflos (CGAP) and Kathryn Imboden (Women's World Banking). 2004. "Helping to Improve Donor Effectiveness in Microfinance: The Role of Governments in Microfinance". Donor Brief No.19. Consultative Group to Assist the Poor (CGAP). p.2

5. Evolution of Microfinance in Latin America

It is estimated that more than 70% of Latin American people are still marginalized from financial access which are offered by formal financial institutions. In addition, only 4% of the rural households can take advantage of banking services. In this circumstance, NGOs have performed a key role since the 1980s by providing microcredit in the rural region. Some of these NGOs have become specialized in microfinance, and then ultimately transformed into regulated-financial entities and banks as the years went by. Due to a large scale of the U.S. government funding and technical assistance programs from the 1970s, many of microfinance programs were advanced at a rapid pace in Latin America.

Among Latin American Countries, Brazil pioneered the industry by establishing a specialized microfinance model at the early stage, in 1970. And a number of microcredit programs were implemented onwards with the technical support and financial aid of the so-called Boston-based microfinance advocacy body which is ACCION that was founded in Venezuela and operated by USAID funding. Although Yunus is often labeled the father of microfinance, the Non Profit Organization (NPO), ACCION, was actually the first to start microfinance, in 1973. After, ACCION's microfinance operators have since spread, with branches not only in Latin America but also in Africa, Asia and the United States.[8]

[8] Kathleen Ryan. 2013. "Colombian Microfinance". Colombia: From Crisis to Renewal. p.112

Even though there were many of difficult social conditions such as dictatorship in Latin America, microfinance has expanded its size throughout the continent from the 1980 onwards, creating new organizations. The introduction of microcredit delivery methodologies were mainly developed by NGOs, and it used to remain outside the formal financial system. Nonetheless, Bolivia was the first country in which the microfinance movement was to accomplish a really innovative breakthrough and turning point. A remarkable exception was BancoSol converted from an NGO into the world's first commercially-oriented microfinance bank[9].

With the start of BancoSol which is an exemplary case around the globe, Bolivia began to give impetus to the way for commercialized microfinance to expand right around the world[10]. Meanwhile, as microfinance continued to enlarge their size in the region, a wide variety of kinds of lenders also appeared, so that NGOs have been joined by banks, credit unions, state institutions, foundations and private business. In some countries such as Bolivia, Peru and Honduras, the regulatory authorities have created specialized non-bank charters for lenders. These are under the category of supervised and monitored financial institutions that should abide by the regulations which are required by the corresponding financial authority.

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9 Milford Bateman. 2013. "Age of Microfinance: Destroying Latin American Economies from the Bottom Up". working paper. Austrian Research Foundation for International Development. p.12

10 Elisabeth Rhyne. 2001. "Commercialization and Crisis in Bolivian Microfinance".

While NGOs still hold a majority of microcredit lending in most countries, in some of cases such as Argentina, private banks and state institutions take large possessions in lending of microcredit. And among Latin American countries, Bolivia and Peru have some of the most developed and successful MFIs, and Colombia was also viewed as one of the leading countries at the initiatory stage in the microfinance development of LACs. Today, MFIs in Latin American and the Caribbean have distinct levels of maturity by each country.

III. Research Methodology

As highlighted before, whether regulatory authorities consider microfinance seriously at early stage and corresponded with a supportive approach is a critical factor which leads the development of microfinance industry in a country. This paper assumes the supportive approach as the introduction of financial liberalization factors in microfinance sector. With financial liberalization factors, regulation and supervision framework is also viewed as a main factor that affects the growth of microfinance sector. The research motivation of this paper stems from the intention to know the reason of gap in terms of microfinance maturity between Bolivia and Colombia.

Even though these two countries have been assessed as countries which have well-established microfinance programs at the early stage of microfinance settlement, with similar amount of the U.S. assistance, the countries now have different levels of development. Over the decades, Bolivia and Colombia have taken their position differently regarding the introduction of financial liberalization factors and regulation framework which sequentially affects the response of private sector in becoming regulated entity. Through doing comparative analysis between Bolivia and Colombia, this paper will look into how the aforementioned two factors have affected the growth of MFIs in each country.

1. Theoretical Approach

This analysis is fundamentally based on historical institutionalism theory. Historical institutionalism (HI) is an institutional social science method that regards institutions as a means of looking for sequences of social, political and economic changes over time. It also aims at explaining the behavior and changes of policies and institutions by systematically showing how events and political decisions can construct policy decision-making of today. According to Charles Tilly (1984), HI theory is an approach which is suitable for measuring “big structures, large processes, and making huge comparisons.”

More specifically, here, Hall (1986) states that institutions can be understood as the formal rules, compliance procedures, and standard operating practices that structure the relationship between individuals in various units of the policy and economy. Meanwhile, Steinmo (2008) also emphasizes that HI theory is especially different from other social sciences approaches by its attention to the real world empirical questions, its historical orientation and its attention to the ways in which institutions structure and shape political behavior and outcomes.

By integrating historical perspective and macro-structural analysis in policy research, it effectively explains the sustainability of policy patterns within a country. Overall, main elements of HI theory can be summarized as follows.

[Table 4. Historical Institutionalism]

Historical Institutionalism (HI) Theory	
Focus	- Importance of history in general - Importance of initial decisions in policies on specific sector
Approach	Retrace history of specific policy sectors or public policies in particular
Institutions	Formal rules, compliance procedures and standard operating practices (Hall, 1986)
Method	Comparative approach based on case studies

Source: Produced by the author

2. Research Questions

[RQ1] "What makes the differences in terms of microfinance maturity between Bolivia and Colombia?"

[RQ2] "Does liberalization really hinder the protection of consumers in Microfinance?"

3. Research Hypothesis

[H1] Elements of financial liberalization affect the development of Microfinance

[H2] Becoming regulated and specialized Microfinance Institutions affects the development of Microfinance

IV. Regulatory Framework of Microfinance in Bolivia and Colombia

1. Case 1 – Bolivia

Given that where regulatory authorities regard microfinance truly on early stage with cooperative responses of regulators but not extremely repressive way has accompanied the development of microfinance, Bolivia's case is needed to be dealt with specifically to see whether the preposition really works or not. Over the last few decades, the Bolivian state has been trying to form an appropriate juridical and regulatory framework which is apt for the demands of MFIs. For this, the regulatory authorities have collaborated with the microfinance industry to settle a specialized microfinance regulatory framework. Due to the early consolidation of microfinance framework and system, microfinance industry of Bolivia is visibly advanced and today it accounts for a specialized part of the formal financial sector.

In fact, Bolivia and Colombia have all undergone financial sector crisis in common and it affected microfinance industry of each country. In this context, Bolivia's financial crisis during the mid-19080s was rather served as a momentum behind the liberalization that paves the way for microfinance. To say again, it produced strong stimulation for new regulatory framework, and then its microfinance regulation and supervision approach was formed with a financial policy which began much earlier than other countries' similar reforms.

1) Financial Liberalization

Above all things, the overall liberalization process in the mid 1980s affected positively the development of microfinance industry in Bolivia. First of all, the government authorities had recognized the importance of microfinance earlier so that they were highly supportive of the industry. The peculiar collaboration of a financial sector policy based on non-interventionist with a strong backing for microfinance led an advanced and mature microfinance environment in Bolivia.

In 1985, President Paz Estenssoro implemented so-called new economic policy which put the government as a medium of regulating and supervising the overall economy rather than controlling it. President Paz Estenssoro carried out a chain of reforms as a way of the administration’s new economic plans to handle the crisis caused by hyperinflation, debt and economic turmoil. This plan became concrete with Supreme Decree 21060 which was a legal instrument that imposed neoliberal economic policies in 1985, and the 166 articles of this charter for a 'New Economic Policy' embodied the most radical changes in policy-making in Bolivia for over three decades[11].

[11] James Dunkerley and Rolando Morales. 1985. "The Crisis in Bolivia". Working Paper Nr.54. Kellogg Institute. p.1

[Table 5. New economic policy paradigm in Bolivia]

"Shock-therapy" (Pres. Paz Estenssoro in 1985)
- Trade liberalization - Deregulation of the financial sector - Privatization of uncompetitive state-owned banks - Implementation of tax reforms
Succeeded in decreasing inflation and bringing about stable economic growth with the rapid growth of microfinance industry in Bolivia

Source: adapted from "Commanding Heights," PBS, 2002

To be specific, financial liberalization in Bolivia led the privatization of state-owned corporations and then liberalized all set prices. In the process, public banks which used to show low competitiveness were closed. Given that the financial sector was vulnerable because of mandatory interest rate ceilings and interventionist policy, the readjusted economic environment from 1985 to 2003 had highly positive effect on the revival of financial sector in the country. By uncapping interest rates and closing of ineffective state-owned banks as mentioned, the role of private sector in providing credit to the Bolivian people has started to play a significant role. Non-Profit Organizations (NPOs) appeared since then, and NPOs such as PRODEM, FIE and ProCredito began offering systematically micro-credit to small borrowers.

In other words, the liberal economic policies from 1985 had produced the impetus to the emergence of microfinance sector, and moreover constructed base stage for appropriate setting for the process of microfinance. Especially, as part of the new economic policy, the Bolivian governmental authorities started to put more emphasis on the task of constructing an appropriate regulation and supervision framework for financial sector as the government rather focuses on its supervision role than being control center of the overall Bolivian economy.

As the role of informal sector such as the aforementioned NPOs increased, policy reforms aiming at fostering competitive microfinance NGOs also implemented during the following years. In 1995, Fondo de Desarrollo del Sistema Financiero (FONDESIF) which is an institution and financial mechanism to provide financial and technological assistance to NPOs of microfinance, under the authority of the ministry of Development was created. In accordance with such legal framework, MFIs enlarged its size geographically including to rural areas of Bolivia.

Due to the closing of all State-owned banks and other financial institutions, a gap in market penetration to small borrowers who demanded these financial services but have been isolated from the formal banks was created. These highlighted changes of economic environment promoted the creation of proper system which is needed for the development of microfinance in the long term. That is, the overall policy changes which are based on liberal economy empowered Bolivia's financial system. Along with it came a series of financial reforms such as a new Acts, Laws and other regulations that led to the growth of the financial sector. In 1985, assets in this industry attained only $40 million; by late 2004, they exceeded $3 billion, after a small drop in the financial system in the late 1990s and early 2000s.

After the government's approach has been shifted from controlling one to supervising it, active competition among various entries to the financial market was fostered and later, the creation of a gap in the financial system could be filled with the appearance of various microfinance providers and it could reach the lower and marginalized sectors of Bolivia. Afterwards, through new banking legislation in 1993 and the establishment of an independent Superintendency of Banks and Financial Entities which technically supervises and regulates the MFIs under the basis of sound and prudential standards, the reform of the Bolivia's financial system could be completed.

2) The Formalization Process from NGOs to Financial Regulated Entities in Bolivian Microfinance

Since financial services which were offered by NGOs to the poor are limited to microcredit as highlighted in previous chapter, becoming officially regulated and supervised microfinance entity is one of the most important factors in terms of benefits of consumers and the MFIs development in the long term. By transforming into regulated microfinance institutions away from NGO, more various financial services including deposit-taking can be provided to their clients and it ultimately affects the maturity of the industry itself. In case of Bolivia, the response of private sector NGOs in regard to being under the category of regulation and supervision is notable in the world.

The so-called “Bolivian Transformation model” had accelerated the growth of the microfinance market and it became a pioneer. PRODEM which was founded in 1986 as a non-profit institution with the goals of adopting microfinance in the urban and rural areas applied for a banking license in 1989 to acquire more opened way to commercial capital and moreover, to expand its outreach. According to Meagher (2006), PRODEM’s lending operations grew up at a rapid pace that by 1989 its portfolio was exceeding the available donor funds. The PRODEM finally obtained banking license in 1992.

Through the transformation process from a NGO to microfinance-specialized bank, the initial commercial bank which provides financial services in the micro-entrepreneurial sector was created. The foundation of BancoSol in Bolivia is meaningful in that it was the first attempt of microfinance NGO around the globe and moreover, the transformation model attracted the attention of regulatory authorities throughout the world. The major outcomes of the Bolivian model can be summarized as follows. First of all, it verified the possibility that microfinance NGOs also can join the financial system and by doing so, financial inclusion can be achieved. Furthermore, the exemplary Bolivian transformation model which was undergone at early stage in the evolution of microfinance paved the way for creating a regulatory framework, which is tailored to the nature and characteristics of microfinance institutions in the country.

In fact, BancoSol is not only just the best performing Bank in Bolivia but also a pioneer that initiated microfinance in a dramatic fashion to the Superintendencia de Bancos y Entidades Financieras (SBEF) as petitioner to accomplish financial inclusion[12]. That is, it became significant part of the regulated financial landscape. According to Rhyne (2002), PRODEM-BancoSol transformation strategy can be seen as a sign of the twin goals of many microfinance NGOs: (1) reducing donor dependence, (2) exponentially increase the number of clients with access to microfinance. If the initial reaction of the BancoSol's organizers was different, the regulation framework of microfinance in Bolivia would be developed differently.

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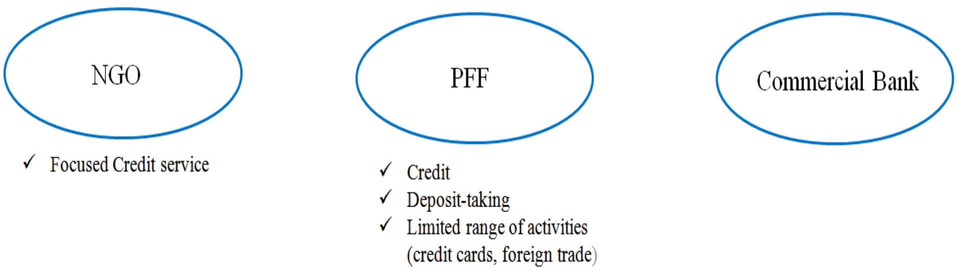
[12] Jacques Trigo Loubière, Patricia Lee Devaney and Elisabeth Rhyne. 2004. "Supervising & Regulating Microfinance in the Context of Financial Sector Liberalization: Lessons from Bolivia, Colombia and Mexico". p.12

Since the regulatory authorities which are SBEF in Bolivia recognized the importance of microfinance industry at its early stage and invested in managing the aspects of MFIs, the first commercial microfinance bank could begin to work on their services with the permission of regulatory authorities. To be specific, even though BancoSol had no ability of complying in some of core regulatory standards, BancoSol set to work based on the understanding of financial authorities that microfinance is essentially different compared to commercial bank system. As a result, the SBEF has evolved as a partner in the development phase of breakthrough taking in Bolivian microfinance.

3) The Creation of Private Financial Funds (PFFs): Legal structure in micro-financial services

With the advent of PRODEM, NGO's interest in becoming regulated financial intermediaries between NGO and Commercial bank increased and this also made possible the creation of Private Financial Funds (PFFs) in 1995. To make the Bolivian transformation strategy more systematic and sustainable, PFFs which is the first institutional structure especially designed for MFIs was demanded. As a result, remaining NGOs began to cooperate with the SBEF to create a new regulatory category for MFIs to become licensed intermediaries without having to abide by all of the existing requisites to become a commercial bank. National Superintendence of Banks (NSB) which plays the role of supervising regulated entities finally introduced PFFs.

[Table 6. NGO, PFF and Commercial Bank]



Source: Produced by the Author

To be specific, Private Financial Funds (PFFs) can be regarded as an intermediary legal institutional which take a position between NGO and fully licensed commercial bank. In Bolivia, both NSB and SBEF regulate and supervise the PFFs. And the Bolivian PFFs are seen as non-bank financial entities since they have some limited range of activities compared to commercial banks. In other words, PFFs are unqualified to provide directly some services which are offered by conventional banks such as credit cards and foreign exchange services. As a result, financial entities which are under the category of PFFs can't participate in the process of expansion of the money supply. The efforts to establish regulations for PFFs mainly revolved around Procredito which was a NGO in 1992, and it finally became Bolivia's the first regulated non-bank financial institutions in 1995[13].

As mentioned, Supreme Decree 24,000, the regulation for the operation of PFFs, a form of MFIs was issued in 1995 and its main articles can be organized as follows.

[Table 7. Supreme Decree 24000]

Adapted some parts of the total articles
Article 1. The organization and functioning of Private Financial Funds (PFFs) is hereby authorized as non-banking financial entities whose principal aim will be to channel resources to small and micro borrowers carrying

13 Joanna Ledgerwood and Victoria White. 2006. "Transforming Microfinance Institutions: Providing Full Financial Services to the poor". The World Bank. p.12

out activities in both urban and rural areas.

Article 2. The Private Financial Funds may operate at the national level and will adapt their incorporation, administration, functioning, operations, merger and liquidation to the provisions set forth in the Law on Banks and Financial Entities, this Supreme Decree and all applicable statutory rules and regulations, as well as provisions issued by the Central Bank of Bolivia and the Superintendence of Banks and Financial Entities.

Article 5. In order to obtain an operating license, the Private Financial Fund must meet the requirements established in the Law on Banks and Financial Entities and submit verifiable evidence to the Superintendence of Banks and Financial Entities that it has recruited qualified professionals with ample experience in savings attraction mechanisms and granting and recovering of small loans as part of its staff.

Source: http://www.bu.edu/bucflp/files/2012/01/Supreme-Decree-No.-24000-on Private-Financial-Funds.pdf

The microfinance clients in Bolivia can be offered with micro-financial services through various types of providers such as Non-Governmental Organizations (NGOs), Credit Unions (CUs), Private Financial Funds (PFFs) and Commercial banks. Among these, the PFFs and commercial banks are the only financial intermediaries which are qualified to have regulated micro-financial provisions. In other words, financial services by NGOs are not under the regulation and supervision framework by the Law on Banking and Financial Institutions nor by the SBEF.

[Figure 1. Providers of Microloans in Bolivia]

Institution	Portfolio of Microloans (Millions of US dollars)	Percentage of Total
Banks(BancoSol)	91.2	22%
PFFs	194.0	47%
Cooperatives	46.4	11%
NGOs	85.9	21%
Total	418.4	100%

Source: ASOFIN (2008)

As seen in the figure 1, the microfinance clients in Bolivia are mostly provided their services from regulated and specialized micro-financial institutions, through BancoSol and PFFs, and it accounts for 69% in the total supply. Meanwhile, NGOs accounted for significantly small portion which is about 21%. From this, it is assumed that professional regulated micro-financial intermediaries are well established in Bolivia and a lot of their clients have benefited from it. Through the provisions offered by regulated and supervised entities, consumer protection could be more assured, too.

The establishment of PFFs also accelerated the formalization of NGOs technologies and operations in Bolivia, requiring from them a minimum capital (of 630 thousand Special Drawing Rights), which is small than that requested from banks, this comes together with a strict prudential framework that establishes limits for supplying credit and concentration smaller than those established for banks. The Supreme Decree establishes that the PFFs should be organized as corporations, since this is a suitable form for financial intermediation, both for artificial stability that represents mercantile institutions to civil society, and for allowing timely increases or equity replenishment, whenever required to do so by SBEF in accordance with the regulatory framework included in the Law on Banking and Financial Institutions.

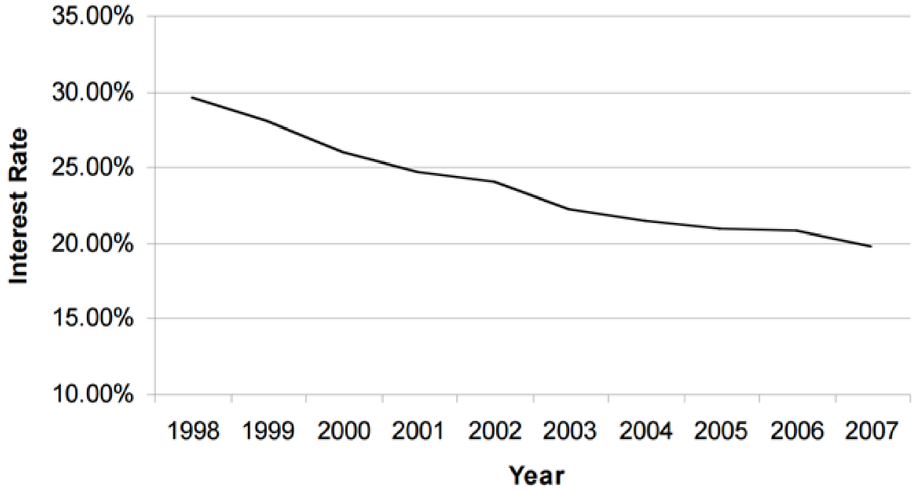
Since the Decree was approved, the concept of FFP has been the legal form which became the starting point from which private initiative has been able to guide its efforts toward filling an unsatisfied credit demand from traditionally excluded sectors of the financial services[14]. With the creation of Caja Los Andes which is the first PFF in Bolivia, the SBEF granted a license to five more PFFs for a few years. In 2008, a generic cyclical provisioning program was implemented into MFI regulation law as a means to evaluate and control portfolio risk[15]. Additionally, the SBEF set up a parallel regulatory and supervisory framework for cooperatives, which has caused the reinforcement of the premier cooperatives by offering

[14] http://www.sa-dhan.net/Adls/Dl1/RegSupr/RegulatoryFrameworkforMFBolivia.pdf

[15] Miguel Delfiner, Anabela Gómez and Silvana Perón. 2009. “Public Policy on Microfinance in South America”. p.8

incentives for leading cooperatives to be eligible for being under the regulation category of the SBEF and by doing so, can have deposit-taking functions targeting the low-income clients. Along with these new plans for the specialized MFIs, the SBEF also created a department which is in charge of microfinance industry and invested a lot in training the staff about the supply of micro-financial services.

[Figure 2. Average Interest rate of Regulated Microfinance Institutions]



Source: ASOFIN (2008)

As above, in the figure 2, interest rates have continually dropped over the years after the implementation of non-interventionist financial approach. Microcredit interest rates are now seen the lowest among LACs. The outcomes of Bolivian regulatory position toward microfinance produced satisfactory results and unprecedented MFIs growth quantitatively as well as qualitatively. Specifically, the emergence of such various entrants providing microfinance has formed a vibrant competition, gradually downed the price of financial products, scaled up a branching of micro-financial products and rather increased quality and the variety of services. During the development process of MFIs, the clients could have real benefits from the positive consequences with apparent impact on beating extreme poverty in Bolivia. The emergence of such markets and its enlargement in the formal financial sector was achieved due to the Bolivian regulatory authorities' political will.

And this enthusiasm in Bolivia has also motivated emerging MFIs in developing countries to set up an appropriate framework that fosters the transformation of microfinance NGOs into financial entities which are devoted to serving the low-income clients. Such overall development process finally generated some characteristics that the Bolivian microfinance of today has.

[Table 8. Characteristics of microfinance in Bolivia]

MF clients	High rate of debt repayment
	Increase of non-lending financial services like deposits
	High portion of individual credit than group lending
MFIs operation	Marketing to acquire more outreach
	Modernization of infrastructure and technology
	Professionals on the economic area instead of the social area

Source: Pablo Ortega Gumucio. 2005. “Bolivia: Evolution of Poverty under liberal economic policies (1985-2003) and Microfinance Poverty Alleviation”. p. 25

To sum up, according to Pedro Arriola (2003), the evolution of microfinance in Bolivia can be organized as four phases. During the mid-1980s, most of microfinance services were possible by NGOs that were more of credit institutions rather than financial intermediaries. Above all, resources portfolio and operational costs were covered by foreign aid in the form of donations and subsidized funds. In the second phase is characterized by the appearance of BancoSol in 1992. The process of MFIs formalization began and the installment of regulated microfinance institutions implemented.

In the third development phase from 1996 to 1998, consumption credit institutions entered the MF market. It was so called a flood of microfinance supply. Even though the entries drastically increased, the traditional financial institutions lacked appropriate strategies to evaluate the capacity of payments and delivery, so that they incurred in the error of lending beyond the client's debt repayment capacity. The third development phase is regarded as economic crisis period from 1999 to 2002. The problems of excessive debt lenders, lack of capacity to repayment came up and credit consumption entities left the market during the this third phase. After the deep economic crisis, microfinance in Bolivia again recovered its stable operation conditions from 2002, so it is called maturation and stable period and has continued until now[16].

During these four microfinance development phases, there always has been the government's strong backing for microfinance as mentioned before. Now, Bolivia is enjoying the maturation and stable period. The positive results which were fostered by the combination of adequate framework of macroeconomic policies and appropriate regulation specific to MFIs made the Bolivian microfinance highly competitive around the globe and its microfinance sector accounts for significantly specialized portion in the formal financial sector. According to ASOFIN, clients of MFIs has roughly accounted for 71 percent in the total banking system, whereas the portion of commercial banks is only about 19 percent in recent years.

The statistical figures are more evident. The percentage of outstanding portfolio investments in the Bolivian financial system was a mere 1.5% at the end of 2013, a historic low. That is even more impressive in comparison to the regional level,

[16] Ibid., p.23

which exceeds 5%. The Economist Intelligence Unit ranked Bolivia as the second best business environment for microfinance in 2013. Indeed, 37% of assets in the financial system are microfinance assets, held mainly by regulated entities[17]. This remarkable growth of microfinance in Bolivia significantly contributed to its economy creating an important number of economic opportunities and above all, the developed formalization process of MFIs was possible by the synergy efforts between the government and the private sector which is represented as NGOs that have successfully proved their capacity in complying with the SBEF's regulation and supervision during the transformation procedure.

[17] Medali Cachicatari. 2014. "The cradle of microfinance, Bolivia remains solid". p. 2

2. Case 2 – Colombia

Even though Colombia has an immense economic scale among Latin American countries and it is ranked as the third in the region in terms of the overall GDP as of 2015, there also has been a high demand for micro-financial services at the same time. According to the Colombian Banking Association, around more than 35 percent of the Colombian adults have no access to any type of formal banking services so they are regarded as “unbanked population,” As a result, the unbanked people have no choice but to lend from informal money and later, they have to pay excessive interest rates. In Medellin, for example, interest rates charged on an individual loan from an informal source can be more than 100 percent per year, in comparison with around 20~30 percent that used to be imposed generally by a commercial bank[18].

Accordingly, Colombia is also no exception when it comes to the needs for microfinance market since such a very high level of income inequality remains in the country. This income dispersion found in the country mostly originates from the labor market, which is characterized by a high unemployment rate that was at 11.9% in 2015. This number is higher than the average of OECD and it even above among the similarly developed LACs. As a widespread informal sector actually accounts for a large portion in the overall employment sector even rather than other LACs

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[18] http://www.iadb.org/en/news/webstories/2013-03-04/banking-the-unbanked-in-colombia,10328.html

(Bernal, 2009;ILO, 2011), the majority of those workers consequentially belong to this informal sector which contains poor-productivity activities. Furthermore, a third of the workers are under-employed[19]. Given that inequality in the country has grown gradually, leaving millions in poverty, it can be assumed that there is a large potential microfinance clientele in Colombia[20]. In 2012, small borrowers of 2.3 million received micro-financial services from MFIs and 6.2 million clients were provided deposit services from MFIs in Colombia.

Although it's not easy to determine how many of these clients actually had incomes below the poverty line, these numbers clearly prove that millions of Colombians are impoverished and they have severely limited access to traditional banking services. Therefore, it is confirmed that the microfinance sector in Colombia has a lot of opportunities to serve these people who have remained outside the banking category. In fact, although Colombia is the third largest microfinance market in regard to the number of clients in LACs behind Mexico and Peru, Colombia only covers 13.6 percent of the potential market which is a small portion of market coverage in comparison with Peru with 26.2 percent and Bolivia with 55.7 percent coverage.

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[19] Isabelle Joumard and Juliana Londoño Vélez. 2013. "Income inequality and Poverty in Colombia-Part1. The Role of the Labor Market". Economics Department Working Papers No. 1036. p.9

[20] Ryan Kathleen. 2013. "Colombian Microfinance". Colombia: From Crisis to Renewal. p.112

From the statistical figures, it is estimated that Colombia has a lot of room for microfinance industry growth and improvements. Nonetheless, the Colombian microfinance industry lags behind many other LACs in spite of these large potentials as a microfinance leading country, whereas neighboring countries such as Bolivia and Peru now have highly advance microfinance environment. Despite its proximity to both, Colombia has lower levels in its MFIs development in comparison[21]. Although Colombia was also evaluated as one of the leading nations with Bolivia, at the early stage of microfinance development in Latin America, these two countries now have apparently different maturity level with regard to the scale and contribution of MFIs. The Colombian case will be analyzed in accordance with the suggested analysis standards which are the governmental authorities' approach to MFIs and the response of private sector about being regulated financial intermediary.

[21] Ibid., p.113

1) Financial Liberalization

The development of regulated MFIs and appropriate regulatory framework which is specific to micro-financial services has been slow in Colombia because of the regulatory authorities and conventional banking community's perspective that microfinance essentially has high and excessive risk. In other words, the governmental agencies have been unwilling to formalize build up its relationship with the microfinance sector[22]. Although financial intermediaries converted into universal banks that were permitted to conduct every type of banking operations along with financial liberalization process, too, it has stuck to some elements of non-liberalized financial system such as interest rate ceiling, continuous operations of uncompetitive public banks and directed credit during a long period in the microfinance development procedure.

Above all things, capping interest rate in the microfinance sector has hindered the efforts of microfinance institutions to enlarge their service outreach to the poorest of poor in Colombia. The Colombian government's direct intervention and strict controls on MFIs has made the competition among various entrants to the market slow, therefore, the Colombian MFIs that provide small loans targeting the low-income people has remained and evolved outside the formal and regulated

[22] Jacques Trigo Loubière, Patricia Lee Devaney and Elisabeth Rhyne, 2004, "Supervising & Regulating Microfinance in the Context of Financial Sector Liberalization Lessons from Bolivia, Colombia and Mexico", p.12

financial landscape[23]. To be specific, Colombia's total portfolio of micro-loan is smaller than Bolivia. Given that Colombian economic size is much larger than Bolivia, it's concluded that there is a clear and huge disparity between these two countries, in terms of microfinance market penetration and its service outreach.

With this unsupportive approach of the government to microfinance, financial regulatory system in place in Colombia has long been restricting growth of their MFIs and hampering its potentials to achieve the similar level of development seen in neighboring countries. Meanwhile, some meaningful changes began to place in the country by the Alvaro Uribe government (2002-2010) with driving force by public. During his presidency, the importance of microfinance on eradicating extreme poverty was highly emphasized as well as the positive impact it has had Colombia and much of the Developing World.

The Uribe administration introduced liberalized financial microfinance programs from 2006 and also, he had made commitments to forming an appropriate institutional and legal mechanism which are adapted to characteristics of microfinance, apart from the existing traditional banks, with the goals of bringing more specialized micro-financial services to more micro entrepreneurs and workers employed in the informal sector. During his presidency, the MFIs was raised as a pivotal means in both revitalizing the economy out of the slump and its long term development down the road. And it was suggested as one of the best solutions at the

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[23] https://100millionideas.org/2009/06/09/remarks-at-opening-ceremony-by-colombian-president-alvaro-uribe-velez/

lowest cost. All in all, the new regulatory and policy initiative in Colombia have improved the microfinance environment creating a more competitive sector with greater outreach. Even though that period was understood as a momentum for the development of MFIs in Colombia, the introduction of financial liberalization factors and supportive approach which recognizes the importance of the industry were driven too late compared to Bolivia and other LACs.

As part of putting more emphasis on the operation which reflects fully the differences of MFIs from traditional banking system, Colombian banking authorities initiated a reporting category specific to microfinance. This has generated a sudden increase in the amount of microloans banks report, rush on the part of banks to expand their services in this region[24]. As some changes start by the Alvaro Uribe administration from the mid-2000s, there also appeared an accelerated growth in microfinance in the country. Among recent changes in the microfinance industry, the agreement which was committed in 2002 between the Colombian government and the country's banking sector in total of 31 banking institutions, with the object of fostering the development of micro-credit by investing their own resources took an initiating role.

Later, the Bank of Opportunities which is a state-owned fund that operates as a second-tier financial entity linking closely micro-credit to the poorest households

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[24] Jacques Trigo Loubière, Patricia Lee Devaney and Elisabeth Rhyne. 2004. "Supervising & Regulating Microfinance in the Context of Financial Sector Liberalization: Lessons from Bolivia, Colombia and Mexico". p.16

through rediscounted and subsidized credit lines was established in 2006[25]. Furthermore, through the enactment of decree 1119 on 2009, direct banking entities were subject not to charge certain administrative fees (up to a certain number of transactions per month and subject to a maximum balance) to low-income clients opening new savings accounts. Considering that the microfinance industry in Colombia has showed slow development growth due to the government's restrictive intervention including interest ceiling, such new legislations can be regarded as a turning point to push ahead with the improvements of Colombian MFIs.

The new legislation also abolished the existing interest rate ceiling for microfinance. The Colombian regulatory authorities have set an interest rate cap at the usury interest rate, which is fixed as 1.5 times that of the current banking interest. Given that the mandatory interest ceiling was considered as a main deterrent which impedes active competition of MFIs in Colombia, the enactment of law on capping interest rates for MFIs served as momentum to foster the long-term microfinance industry development. Now, interest rates on micro-loans are regulated by national law and a national decree that was modified in 2008 to facilitate the expansion of MFIs and also as part of distinguishing micro-lending from consumer lending[26].

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[25] Adriana Hoyos, 2012, "Colombia Country Report", Center for International Development at Harvard University, p.21

[26] http://www.triplepundit.com/2011/08/thriving-microfinance-sector-strengthens-colombias-economy/

2) The Formalization Process from NGOs to Regulated Financial Entities in Colombian Microfinance

The regulatory and supervisory framework in the Colombian microfinance sector is shaped around deposit-taking and non-deposit taking microfinance service providers. The Financial Superintendence of Colombia (FSC) is the main regulatory body of deposit taking microfinance service providers. Cooperatives and saving and loans associations are overseen by the Economia Solidaria Superitendency. The majority of NGOs that provide micro-credit to small borrowers don't belong to any regulatory body[27]. As highlighted, MFI's deposit-taking function is both helpful for the client and for the MFI itself in becoming self-sustaining financial entity.

All in all, deposit-taking function of MFIs is also understood as a way to acquire cost effectiveness in that deposits are a low-cost source of funds to lend back to clients. Considering that favorable regulatory environment where NGOs which provide microfinance services can have an opportunity of converting into regulated financial intermediary with the purpose of being "financial inclusion" is crucial in the long-term growth of microfinance industry, Colombian NGOs' reaction to the regulatory environment also should be dealt with specifically to find out the reason why Colombian microfinance has evolved outside the regulated financial system, namely, not achieving financial inclusion.

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[27] http://www.mftransparency.org/microfinance-pricing/colombia/

Unlike Bolivian experience, microfinance NGOs in Colombia have been reluctant to transform into regulated financial providers due to the hostile regulatory environment which was structured by the government. That is, Colombian NGOs have been hesitant to becoming regulated entities, regardless of the possibility of being under the regulatory category, the Commercial Finance Companies (CFCs), which is a similar financial intermediary to PPF in Bolivia. The remaining NGOs which have offered microfinance products but evolved outside the financial inclusion addressed the following elements as some of the regulatory hindrances: 1) interest rate ceiling targeting regulated institutions 2) regulations on portfolio quality and the current ratio index, 3) high reserve requirements, 4) inability of regulated entities to borrow long-term from other regulated entities, 5) restrictions of CFCs to deposit-taking only in the form of time deposits (no savings or checking accounts)[28].

Even though regulations which permit CFCs to develop saving accounts and borrow from formal banks with the aim of mitigating some of these limits CFCs hold have been enacted, but it's still unclear that NGOs can become CFCs with these recent inducements. Meanwhile, new microfinance programs and framework which were implemented as an incentive to boost microfinance industry during the Uribe administration still have some limits to foster the self-sustainable microfinance environment in that directed credit has been used as one of the main

[28] Jacques Trigo Loubière, Patricia Lee Devaney and Elisabeth Rhyne, 2004, "Supervising & Regulating Microfinance in the Context of Financial Sector Liberalization: Lessons from Bolivia, Colombia and Mexico", p.17

way of promoting microfinance market and it actually has accounted for a substantial portion in the alternatives which were suggested by the government.

Due to unsupportive regulatory environment over the last decades in Colombia, several Colombian microfinance institutions have played a significant role by serving significant numbers of people profitably. It means that regulatory authorities don't by themselves drive the development of microfinance sector, rather innovative and determined operations in the private sector has been the most important player and driving force in the total provisions of micro-financial services. In comparison with Bolivia, the stance of regulatory environment of Colombia until recently forms comparatively small portion in market penetration.

[Figure 3. Providers of Microloans in Colombia]

Institution	Portfolio of Microloans (millions of US dollars)	Percentage of Total
Private Banks	89.9	28%
Public Banks (Banco Agrario)	103.8	32%
CFCs	16.0	5%
Cooperatives	0.9	0%
NGOs	115.1	35%
Total	325.8	100%

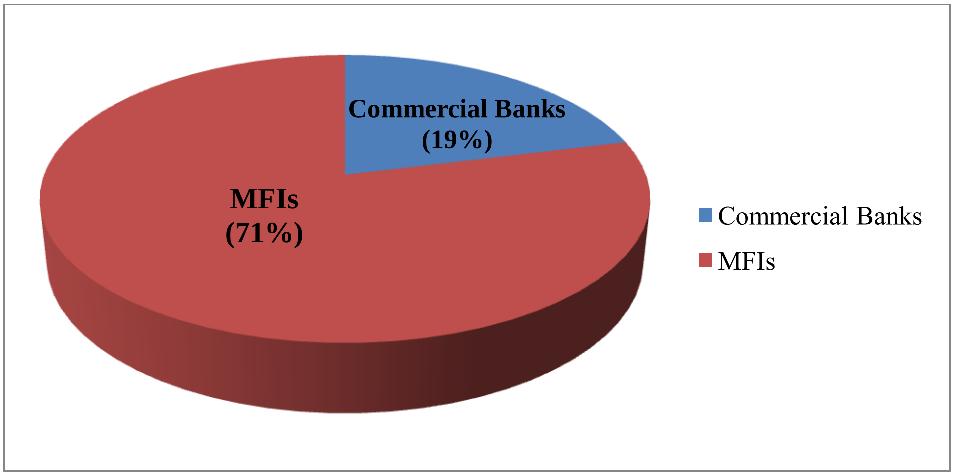
Source: Colombian Superintendecny of Bank (2008)

According to the figure 3, NGOs and non-specialized microfinance providers such as private and public banks mostly offer the provision of micro-financial products. The CFCs, which are specialized and regulated microfinance intermediary, only account for 5 percent in the total operations, whereas the most provisions are given by NGOs that are not being monitored and supervised by any regulatory body. Since the country only has two regulated and specialized CFCs, there have been some limitations in expanding their services offered by regulated financial intermediaries. In addition, cooperatives in Colombia are not that active as seen, while NGOs and banks contribute to the bulk of microfinance loans. .

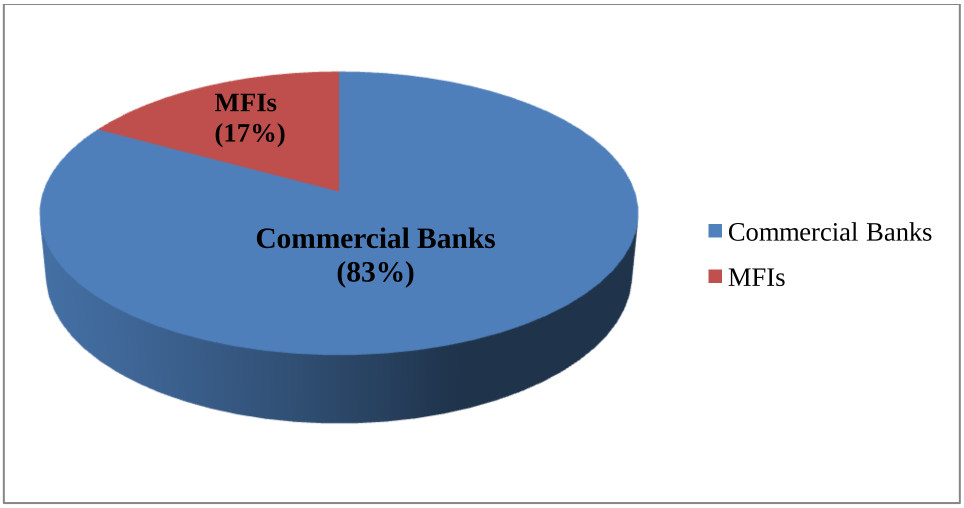
On the other hand, in Bolivia, the PFFs and BancoSol which are regulated and specialized micro-financial entities are forming a greater share of the supply of microloans in Bolivia, about 70 percent in the total providers (Figure 1). In contrast, the NGOs in Bolivia only account for 20 percent. In addition to the contribution of PFFs and BancoSol, NGOs and Cooperatives have also been widely acclaimed for its outreach and services in the rural areas of Bolivia. In case of Colombia, inactive operation of CFCs is originated from the hostile regulatory environment where the NGOs have been passive about being regulated financial entity due to the unsupportive approach of the government over a long period of time.

There is also an apparent disparity between these two countries, in terms of the coverage of MFIs in the total banking system in each country. As mentioned in previous chapter, Bolivia's microfinance sector is represented as a specialized portion in the formal financial system, it is estimated that about more than 70 percent coverage.

[Figure 4. Bolivian clients in the total banking system]



[Figure 5. Colombian clients in the total banking system]



Source: ASOFIN (2008)

On the other hand, the share of Colombian MFIs in the total financial coverage is smaller than 20 percent. Even though there has been a high demand and potentials for the microfinance industry, Colombia still has low microfinance market penetration in the total banking system. In recent years, Colombia has begun working on to set up a new regulatory framework when it comes to microfinance operations of regulated intermediaries from the Uribe administration, though there still needs more concrete plans which are apt for the microfinance market itself. Ryan Kathleen (2013) suggested that appropriate prudential and non-prudential regulatory practices are requisites. And she also mentioned that the financial authorities have to consider mitigating capital requirements for MFIs and by relaxing other factors of the regulatory and supervision environment in Colombia, MFIs would be fully operational in providing more various micro-financial services to their clients.

The recent changes aiming at developing comprehensive microfinance legislation are focusing on releasing a regulatory framework which is apt for operating regulated MFIs. As the market matures, most influential players have converted or are in the process of becoming regulated under the Superintendencia FInanciera. The governmental authorities, banking communities and multilateral organizations have been collaborating with Asomicrofinanzas (the association of MFIs) and directly with MFIs to understand the idiosyncrasies of this market. In 2009, Colombia enacted a comprehensive series of legislations addressing small borrowers' client protection which contained rules about price transparency and dispute resolution[29].

As seen from the case of Colombia, there has been recognition of the Colombian government about the role of microfinance and its effectiveness on poverty reduction in recent years and it has improved the microfinance environment significantly. However, considering that the MFIs development in Colombia was slow due to the government's passive approach and its interventionist policy for such a long period of time, constructing an appropriate regulatory system which fosters the vibrant competition among entries and integrating it more specifically is more suggested as key for the country to enhance its microfinance environment.

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[29] Economist Intelligence Unit. 2012. "Global microscope on the microfinance business environment 2012". p. 41

3) Comparative Analysis of two countries

Through these case studies and comparisons, it is found that Bolivia and Colombia have experienced different development process in terms of microfinance industry. Even though both countries have a widespread recognition about the role of Microfinance Institutions (MFIs) in common, each different governmental approach including regulatory framework has generated distinct microfinance environment in these two countries.

First of all, the governmental authorities of Bolivia were highly supportive of the industry from the beginning of 1990s and created a system of specialized microfinance regulation and supervision framework very earlier than any other countries. In contrast, in case of Colombia, the government has begun to consider initiatives focusing on MFIs recently from the mid-2000s, by the Alvaro Uribe government. As a result, there have been no regulations which are specific to microfinance-specialized institutions until recently. Thus, it's assumed that the two countries' starting point in setting the base stage for microfinance was distinct due to each government's different approach. Meanwhile, both countries also have showed obvious differences regarding the introduction of financial liberalization factors in the operation of MFIs. In case of Bolivia, liberalized financial policies which can be represented as closing of uncompetitive public banks and uncapping interest rate were adopted at its initiatory stage from 1985, as part of New Economic policy. During the procedure, new providers of micro-financial services appeared and they have leaded vibrant competition among the entries. However, Colombia has maintained its interventionist policy during a long period of time until 2006. To be specific, after the implementation of new economic policy in Bolivia, interest rates continuously dropped and now Bolivia has the lowest interest rates which are applied to micro-financial products among LACs. On the other hand, the Colombian government has maintained fixed interest rate, at 39.89 percent during a few decades. Therefore, it has been difficult to expect to experience the continual reduction in interest rates fostered by active and healthy competition among MFIs like Bolivia.

Above all, the response of private sector in becoming regulated and specialized micro-financial entity has been clearly different in each country. In Bolivia, the formalization process from NGOs to PFFs was active with the government’s strong backing for microfinance industry under the basis of favorable regulatory framework for MFIs. Though, the NGOs of Colombia have been reluctant to become CFCs, which are being monitored and supervised by financial authorities, due to its unfavorable environment for the market. Consequentially, most supply of micro-financial services in Bolivia is given by specialized and regulated microfinance institutions, so their clients can enjoy benefits from various financial products from PFFs and BancoSol. In contrast, the majority of microfinance supply in Colombia is provided by NGOs. Thus, it can be assumed that Colombian people are still relying on unregulated financial intermediaries and a limited scope of micro-financial products.

V. Conclusion

This paper provides an in-depth case study on microfinance market in Latin America, especially focusing on a comparison of Bolivia and Colombia. From this comparative analysis, it is found that disparity between Bolivia and Colombia, in terms of microfinance development, is originated from each different governmental approach for microfinance institutions.

Bolivia of today is not only a pioneer in Latin American microfinance but also has one of the most developed microfinance sectors around the globe. Through the experience of Bolivia, it has been confirmed that non-interventionist policy with strong backing for microfinance at its early stage positively affects the development and maturity of microfinance industry. Meanwhile, Colombia has maintained its unsupportive approach with unfavorable regulatory framework for microfinance institutions until the mid-2000s. Even though there have been some improvements fostered by recent initiatives and regulatory framework targeting microfinance sector, it still has substantial limits in integrating microfinance more thoroughly into the formal financial system. And it is required more systematic investment to build up a competitive microfinance climate with greater outreach.

Moreover, it has been verified from the case of Bolivia that becoming regulated and specialized microfinance institutions positively affects the development of microfinance in a country by enhancing the level of price transparency, variety of services and consumer protection. That is, an active competition among microfinance providers didn’t hamper consumer protection and it rather fostered an accelerated growth in Bolivia. From the procedure, Bolivian consumers have benefited ultimately by receiving more diverse micro-financial products at a low cost. In addition, consumer protection is highly assured in Bolivia due to a supportive regulation and supervision framework which encourages the formalization process from NGOs to specialized microfinance intermediaries that are being monitored under the category of financial regulation and supervision.

Through the experiences of Bolivia and Colombia, this comparative analysis finally argues that constructing an appropriate regulatory framework which aims at creating an environment where specialized and regulated microfinance institutions can be established is the key to the development of microfinance market in a country.

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국문초록

규제체계가 소액금융 기관의 수행능력에 미치는 영향: 볼리비아와 콜롬비아의 비교를 중심으로

1970년대 이후, 미국의 재정적·기술적 지원을 기반으로 라틴아메리카 국가들에서 소액금융 산업이 기반을 갖추게 되었고 소액금융 기관들의 수행능력이 빈곤감소에 미치는 영향에 대한 관심이 증가하기 시작했다. 특히, 기존의 전통적인 은행 서비스로부터 소외되었던 빈곤층, 자영업자, 비공식부문 노동자들에게 보다 열린 금융기회를 제공한다는 점에서 소액금융은 빈곤퇴치를 위한 개발도구의 하나로 제안 되었다.

한편, 소액금융 기관 활성화를 위한 방안으로서 각 국가들의 적절한 규제환경 구축이 강조되었고 이에 기반한 보다 전문화된 소액금융 기관이 가진 역할의 중요성이 대두되었다. 또한 이는 한 국가 내의 소액금융 환경의 성숙도를 결정 짓는 주요 요소 중 하나로 간주되어 왔다. 따라서, 본 연구는 볼리비아와 콜롬비아의 사례를 중점적으로 분석하고 비교함으로써 정부의 적절한 규제환경 구축이 전반적인 소액금융 환경과 기관들의 발전 정도에 실제로 어떠한 영향을 미치는가를 분석하고자 하였다.

키워드: 소액금융, 공적개발원조, 규제환경, 라틴아메리카, 빈곤 감소, 비정부기구

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