Building Institutional Capacity

The Story of

prodem

1987 - 2000

Cheryl Frankiewicz

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A Calmeadow Publication

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PREFACE

This document was written as part of the final phase of a six-year, C$4 million institutional strengthening and diversification project that was funded by the Canadian International Development Agency (CIDA) and administered by Calmeadow. The project was designed in 1993 to support the Foundation for the Promotion and Development of Microenterprise (Prodem) in its efforts to diversify into less populated areas of Bolivia and to develop new financial services for the country's informal sector. The project concluded at the end of 1999 and this document was commissioned to share some of the lessons learned during Prodem'scapacity building process.

Calmeadow is a registered Canadian not-for-profit charitable organization based in Toronto, Canada. Founded in 1983, the organization has been actively involved in microfinance since 1985 here in Canada and abroad, specifically Latin America and Africa.

FOREWARD

The idea of reducing the gap between the rights and responsibilities of those who have too much and those who have too little is as old as civilization. History deals with nothing else. Actually, nothing meaningful was accomplished to reduce these inequalities until the consolidation of democratic thinking well into the 20th century. However, true democracy, in practice, touched only a few, while a large portion of the world's population stayed and continues to stay behind. Most of the world remains underdeveloped and eager to catch up. The extraordinary progress in communication and education are heightening the awareness of this reality, but humankind is still divided between the haves and the have-nots. This gap seems to be widening, not closing.

Poverty, marginality, dependency, participation, initiative, opportunity, solidarity, democracy, charity, and sustainability... these are some of the many ideas that inspired the creation of Prodem. Nearly two decades later, the Prodem idea is now a successful reality. Of all these concepts, two are the most fundamental: poverty and opportunity. In a nutshell, the primary mission of Prodem is to enhance opportunities as a means to reduce poverty.

Poverty defines the problem. It also presents a challenge. It is the simplest and the cruelest expression of inequality. For some people solving the poverty problem is a simple act of charity, but for those who are really concerned and truly committed to finding solutions, it is also a responsibility. If it is not properly and effectively addressed, there will be neither real peace nor a sustainable answer to the problems of development.

Poverty is a keyword, an uncomfortable word. It is the lens through which one should see the problems of economic and human development. Today many academics use poverty to demonstrate the consequences of failed attempts to achieve credible development. However, overuse of the term generates confusion because it is too easily forgotten that poverty is the result and not the cause of most development shortcomings.

Opportunity is another keyword. It is an attractive concept for the intellectual community but, curiously, it is mostly used by pragmatic problem solvers. If all problems were considered opportunities, there would be fewer problems. In the case of poverty, it will never be reduced unless the poor are given the opportunity to be part of the solution. The poor are the victims of poverty and, unless they are given the opportunity to get out, they will remain there.

Throughout history, the most frequent and recurring error of judgment made in the attempts to reduce inequalities has been to try to solve the problem for someone else. Doors can be opened, distances can be shortened, but no one can assume someone else's responsibility. "I can hold you, lead you, show you, even carry you on my shoulders, but I cannot walk for you. If I try to do it, you will always stay behind." Unfortunately, this simple and critically important concept is often forgotten.

A well-defined problem is half of the solution. We defined poverty not as a lack of money, but a problem of access to money. This was step one. Step two was then easier: how to develop access to funds, instead of throwing them at the problem? Access to credit was the answer. Prodem's decision to use credit to fight poverty was a significant landmark.

That explains how and why the original mission of Prodem was conceived and got this institution to step into the fascinating world of microfinance. A seed was planted and many followed the example. This evolved into a whole new industry where several hundred initiatives are now working around the world. Nothing succeeds as well as success. Although microfinance does not and will not necessarily solve poverty, its impact is both unquestionable and increasing.

However success is never risk free.

Credit is not money; it is access to money. Easy money is not an opportunity. On the contrary, it can be very destructive. Unfortunately, not everyone makes the distinction. Those who think that easy money will do the trick are wrong. When these people are supported with lots of funding, they put the whole industry in danger. Easy money, either to clients or to microfinance institutions, is the number one threat to the microfinance industry. We need to rethink how funding should be used to expand and improve the delivery of financial services to the poor.

Success attracts many imitators and opportunists. Some imitators understand well and contribute positively to the development of the industry; however, there are others, seeking personal gain, who retard the process. The most obvious opportunists are the politicians who view the masses of poor people as an irresistible temptation. After easy money, politics is the next menace to the sustainable success of microfinance. Politics resurrects paternalism, which had waned but is now dramatically emerging, clinging to the coattails of microfinance and its accomplishments. Politicians are not alone. Many other opportunists are joining the procession and trying to get rich quick and/or boost their public image.

No success is free of risks. Success must be safeguarded to ensure its sustainability. There are and will always be many threats, but microfinance—with protection from easy money, bad imitators and opportunists—can stand well on its own as long as it doesn't stand still.

The spectacular growth of microfinance, aside from providing tangible and measurable benefits, has also revealed new realities: credit alone is effective and significant, but not sufficient. A whole world of new challenges now emerges. Credit as a tool was initially chosen because it was simple and fast, however it definitely does not cover the whole distance. Prodem is satisfied with its contribution to microfinance, but to fulfill its original vision and mission, the organization now faces the challenge to protect its accomplishments while developing new opportunities, such as non-financial services, that will open doors for poor entrepreneurs. Access to funds is one thing, but the capacity to use those funds well and competitively is another. Prodem is now enthusiastically entering this new universe.

At its start there were many people behind the Prodem initiative. First, there were the pioneers, thinkers and innovators who were fortunate enough to come together with their creativity perhaps by accident. Secondly, and more important, are the doers and the operators, who were identified, recruited and organized by the pioneers, and made the idea work. It is to the latter that success is owed, and is to them, in particular, that this book should be dedicated.

Fernando Romero
Chair, Prodem Board of Directors
La Paz, Bolivia

My introduction to Prodem in 1987 was a personal watershed moment and an opportunity to participate in a potentially historic event. The concept of credit as a tool of economic improvement for the poor was at the heart of Prodem. But this was not a new concept or idea. What made Prodem so unique was the amalgam of personalities, an invigorating marketplace, an encouraging environment, and a strong sense that this was the time and the place for bold new steps.

Microfinance, as we know it, is indebted to Prodem. The lessons learned and those still emerging from it will continue to influence the evolution of the sector around the world for years to come. At the heart of this incredible success story are three giants of the Bolivia microfinance community. Eduardo Bazoberry, Pancho Otero and Fernando Romero. Their vision, drive and leadership have both propelled and sustained it. I strongly believe that without them the Prodem story would have unfolded

in a dramatically different way and the evolving microfinance movement would be in a different and lesser place than it is today.

I recommend this publication as a helpful and inspiring guide and companion to those in the field of microfinance who, with their own distinct blend of visionary passion and determination, are advancing on their own challenging path to success.

Martin P. Connell
President, Calmeadow
Toronto, Canada

ACKNOWLEDGEMENTS

I would like to thank the many individuals who took the time to share their piece of the Prodem story with me, in particular the staff of Prodem branches in Batallas, Betanzos, La Paz, Minero, Sacaba, Sucre, and Viacha. I shall not hide the fact that within Prodem's circle I found some of the most inspiring people I have ever had the pleasure to meet and I am indebted to them for making the writing of this book a very rewarding professional journey.

I would like to extend a special thanks to Eduardo Bazoberry, who in addition to sharing his own view of the world, provided nearly unlimited access to Prodem's staff and files; to Pancho Otero, for making me part of his team for two years and for enriching my understanding of microfinance during that period; and to Maria Otero, for inspiring me to travel to Bolivia for the first time in 1997.

Thanks also to Sergio Prudencio, Marcelo Maella, Jose Becerra, Miguel Lopez, Jorge Arias, Javier Bascope, Victor Céspedes, Jhonny Garrido, Jose Herrera, Eliana Otondo, Maria Elena Querejazu, María Renée Aparicio, Rodrigo Oriheula, Carla Quiroga, Mario Cesar Colque, Mauricio Arraya, Juan José Balderrama, Pilar Ramirez, Kurt Koeningfest, Reynaldo Marconi, William Burrus and Stephen Gross for the considerable time and energy they spent explaining how the many pieces of the Prodem story fit together. A very warm thanks to Karen Ormachea and Sandra Quiroga for always making me feel welcome when I walked in Prodem's door, and for helping to bring the logistics of my field visits together.

I am most grateful to Barbara Calvin, Carlos Castello, Martin Connell, Stefan Harpe, John Owens, Elisabeth Rhyne and Fernando Romero for their substantive comments on a preliminary draft. The final document benefited significantly from their experience and insight. I also owe a huge round of thanks to Craig Churchill for his guidance, editing, and patience. It was a pleasure to work with him, William Moore, Rosalind Whelan and Martin Connell in the production of this document.

Finally, a note of personal thanks to the family and friends who supported and endured me throughout the writing process. The journey would not have been half as much fun without you.

Cheryl Frankiewicz
Ottawa, Canada

INTRODUCTION

"The birth and maturation of Prodem and BancoSol illustrate how to create an outstanding microfinance institution. The achievements of Prodem in both its incarnations, and of BancoSol, have amply rewarded the efforts of their founders and contributed enormously to the development of microfinance, both in Bolivia and internationally."

– Elisabeth Rhyne, Mainstreaming Microfinance

Much has already been written about microfinance in Bolivia, a country whose microfinance industry is considered by many to be the most advanced in the world. The number and variety of institutions present, the extremely competitive environment, the degree of market saturation, and the relatively progressive regulatory environment make the country one of the industry's favorite case studies.

The institution that has been most consistently on Bolivia's innovating edge is Prodem. It was the first organization to build sustainable microlending operations in both urban and rural areas of the country. It launched Latin America's first microenterprise bank, Banco Solidario, S.A., which continues to be the largest microlending institution in Bolivia today. It created the country's first rural-based private financial fund, Prodem Oportunidad, FFP, which was the first, and thus far the only Bolivian microfinance institution to introduce smart cards and automatic teller machines. Together with FIE, it nearly concluded the industry's first merger. Today, while BancoSol and Prodem Oportunidad continue to expand their financial services, the Prodem Foundation is entering into joint ventures with microentrepreneurs in an attempt to open up their access to increasingly global and competitive markets.

What this document seeks to add to the available microfinance literature is an in-depth look at how Prodem managed to achieve such innovation. In particular, how did it develop the capacity to create three successful institutions in just over a decade? What were its strategies, its tricks of the trade, so to speak? And how did its strategies have to change over time in response to a changing external and internal environment? Prodem's story is shared here in a fairly technical manner. The text is filled with specific examples of the economic, social, structural and programmatic challenges that Prodem faced and the processes through which it dealt with them. The purpose of the analysis is not to provide a user's guide for replicating the Prodem experience because, ccearly, it cannot be replicated. Every microfinance institution develops in its own unique environment and, ultimately, must find its own way forward. Rather, the purpose of telling the story is to shed some light on the capacity building process through which Prodem became such a strong institution. By telling Prodem's story from this perspective, the document aims to provide readers with insight, ideas and strategies that they can apply within their own institutions regardless of the specific circumstances in which they operate.

The text divides Prodem's story into three parts. Part I provides an overview of Prodem's history and its achievements over time. It introduces the actors and issues involved in the story and describes the events that characterize the institution's development. Part II begins the process of picking Prodem's history apart. It examines how Prodem designed and developed its institutional culture, structure and human resources to provide the sold foundation it needed for growth. Part III then analyses how Prodem built upon that foundation. It explores some of the processes, systems and relationships through which Prodem provided its clients with a valuable service in a sustainable fashion. To conclude, a final chapter offers some closing thoughts on the future prospects of the Prodem Foundation and the two financial institutions that it created.

PART I
Making History

"At Prodem, paradigms are broken."

–Victor Coronado, Branch Manager, Sucre

When Prodem opened its doors in 1987, the idea of creating sustainable financial services for poor microentrepreneurs was ridiculed. Popular opinion held that microentrepreneurs in countries like Bolivia were simply too poor and too poorly educated to manage a loan responsibly. They were certainly too poor to save. Politicians smirked when Prodem said that the lack of financial services available to poor microentrepreneurs actually contributed to their underdevelopment and that if such services were accessible, borrowers could and would make use of them. They just about fell over laughing when Prodem asserted that the provision of such services could be sustainable, and then became outraged when Prodem proposed to charge its poor clients a rate of interest that covered the cost of its service.

In the face of this opposition, Prodem went ahead with its revolutionary idea and in less than five years it proved popular opinion wrong. Poor microentrepreneurs did need access to financial services, they were capable of managing them, and they were willing to pay market rates for services that were of high-quality and were provided over the long-term. By February 1992, Prodem had created an operationally self-sufficient urban microcredit program and had transformed that program into a commercial bank, Banco Solidario, S.A. (BancoSol).[1] BancoSol was the

[1] As of December 31, 1991, Prodem was operationally self-sufficient in the sense that its financial income covered 114 percent of its financial, administrative; and provisioning costs. At the time, it was only 76 percent financially self-sufficient. It did not yet generate enough income to fully cover the cost of inflation and the imputed cost of capital.

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finanzas: Boletín Financiero (La Paz), no. 3

CHAPTER 1
Prodem's Story

To tell Prodem's story is to describe the history of not one but three institutions. That history becomes confusing if it is told in a strictly chronological manner, since separate events in different institutions took place simultaneously. Thus, the story is described here in phases. Organizing the chapter in this manner makes it possible to view at a glance the stages of development through which Prodem passed during its lifetime. It also makes it easy to identify some of the lessons learned during each stage and to explain Prodem's transitions from one stage to the next. While the chapter provides some insight into the economic, political and regulatory environment in which Prodem developed, these references are generally kept to a minimum since they are explored thoroughly elsewhere.[5] The various phases of Prodem's development are introduced below in the order in which they occurred, although their dates often overlap. To help clarify the overall timeline, Figure 1 summarizes the key milestones from each phase and provides a useful tool for understanding Prodem's position at any particular moment in time.

The Founding of Prodem

Prodem's origin lies in a series of conversations between two friends: Fernando Romero, an influential Bolivian businessman and president of the Bolivian bank, Banco Hipotecario Nacional, and Jack Duncan, an American businessman who was founder and president of Acción International, a US-based, non-governmental organization that by 1984 was sponsoring microenterprise credit and training programs in eight Latin American countries. Duncan and Romero discussed the idea of creating a microenterprise program in Bolivia and in 1985, Acción sent Robert Christen to Bolivia to assess the feasibility of such a program.

[5] An excellent analysis of the external environment in which Prodem developed can be found in Elisabeth Rhyne's recent book, Mainstreaming Microfinance: How Lending to the Poor Began, Grew, and Came of Age in Bolivia (Bloomfield, Conn.: Kumarian Press, 2001).

first commercial microenterprise bank in Latin America and the largest bank in Bolivia in terms of the number of clients served.

Once Prodem succeeded in proving the viability of microfinance in urban areas, it turned its attention to providing similar services in rural areas. Again, popular opinion expected Prodem to fail. In other parts of the world, the only sustainable microfinance programs serving rural populations operated in countries with high population densities. Bolivia had one of the lowest population densities in the world and was the poorest country in South America. The challenges of providing credit in that environment were so great that even Prodem's supporters had their doubts about the feasibility of what it wanted to achieve.

Nevertheless, by January 1997, Prodem had built a fully self-sufficient network that included 22 rural branches and 11 branches in secondary cities and semi-urban areas.[2] As of December 1998, Prodem's 50 branches served more than 46,000 clients with an active portfolio of $24 million.[3] It was the largest rural microcredit provider in Bolivia, and had the second largest client base in the country, second only to BancoSol.[4] On December 31, 1999, Prodem successfully concluded the process of creating its second regulated financial institution, Prodem Oportunidad, FFP, after which time it shifted its attention to the development of non-financial services for microentrepreneurs.

Prodem broke numerous paradigms in its relatively short lifetime, and succeeded on several fronts in achieving what had previously been thought impossible. In that respect, it made history. This section of the document explores that history by summarizing the story of Prodem's institutional development and by analyzing its achievements compared to those of other microfinance institutions. It provides the background necessary for understanding how Prodem made a habit out of breaking paradigms, and how it developed and implemented new approaches to replace the paradigms it debunked.

[2] According to Prodem's monthly indicator statements, its branch network fully covered its operational costs, the cost of inflation, and an imputed cost of capital of 13.4 percent in January 1997.

[3] Unless otherwise mentioned, Prodem statistics were taken from the institution's monthly

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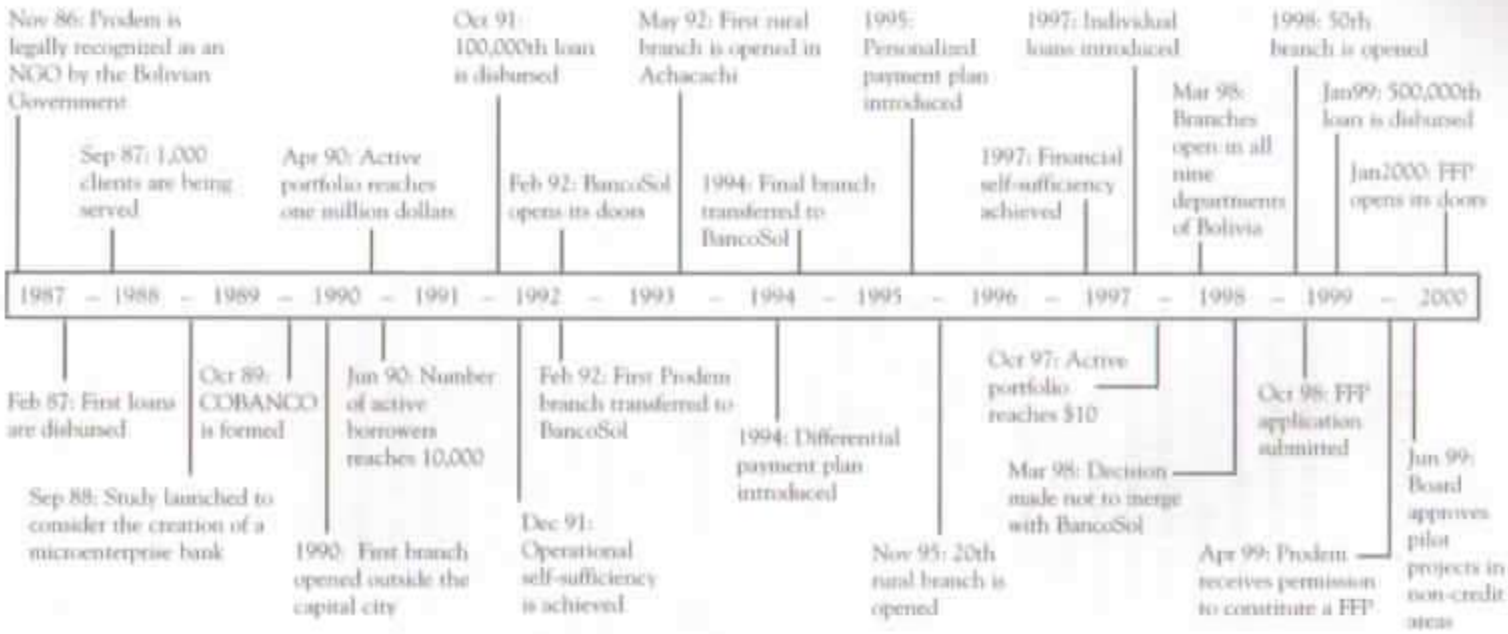

Figure 1: Prodem's Timeline

The results of Christen's study were eventually presented to a group of businessmen with which Romero was affiliated, the Federation of Private Entrepreneurs of Bolivia. After a persuasive presentation by Duncan and Acción's Steve Gross, as well as some enthusiastic arm-twisting on the part of Romero, a handful of businessmen committed $80,000 to the establishment of the non-profit foundation that would become Prodem.[6]

Although the initiative was delayed for more than a year by the insecurity and hyperinflation that characterized the Bolivian economy in the mid-1980s, by September 1986, the economy began to stabilize and an additional $560,000 in grants and local currency loans was pledged by USAID in support of the project. In October, Acción hired Prodem's first executive director, Francisco (Pancho) Otero. A US-educated, Bolivian national with significant rural credit experience and an activist's commitment to social change, Otero possessed a powerful vision for the institution and quickly recruited and motivated a team to launch the foundation's initial activities.

With leadership, staff, financial resources and technical support in place, the Foundation for the Promotion and Development of Microenterprise (Prodem) became a legal reality on November 17, 1986. It was recognized by the Bolivian Government as a non-profit, non-government organization whose mission was to enhance the quality of life of Bolivian microentrepreneurs through support of their productive activities.[7]

The First Five Years of Operation

Prodem issued its first loans in February 1987, three years after the process of creating the microenterprise program began. Twenty market women from a neighborhood in La Paz organized themselves into four groups and received a total of Bs. 2,000 in loans (an average of $51 per person). The lending technology used is now well known as the solidarity group methodology. It was introduced to Prodem by Acción based on its experiences in other Latin American countries.[8]

Prodem used the solidarity group lending methodology to provide loans to two types of clients. In February 1987, it began lending to small traders who needed working capital to purchase consumer goods such as fruit, vegetables, clothing, or basic household staples that they would sell for a

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[6] All dollar amounts provided in this document refer to United States dollars unless otherwise indicated.

[7] Government of Bolivia, Resolución Suprema 201782 (La Paz, November 17, 1986) 1.

[8] For more information on the solidarity group lending methodology, see Maria Otero, The Solidarity Group Concept: Its Characteristics and Significance for Urban Informal Sector Activities, Acción Monograph Series No. 1 (New York: PACT, 1986).

profit. Initial loans to these borrowers were generally for 100 Bs. (approximately $50) and had a two month repayment term; subsequent loans were scaled up almost automatically, progressing first to 200 Bs. with a two and a half month term, then to 300 Bs. with a three month term, and so on.

In June 1987, Prodem began lending to small manufacturers, such as shoemakers, tailors and bakers. These borrowers generally needed larger amounts of initial working capital, but would add 50 percent or more value to their raw materials through the production process. The loan terms for these borrowers were modified taking into account their different cash flow. Initial loan amounts were up to 300 percent larger than those of small traders, payment periods were up to 50 percent longer and installments were payable monthly instead of weekly. The procedure for accessing subsequent loans was similar to that for small traders in that loan terms and amounts were scaled upward with time, but the amounts were generally based on need and did not follow an automatic procedure.

During its first five years of operation, Prodem's portfolio grew at an average annual rate of 134 percent by offering only one product—the solidarity group loan—to these two types of clients. This high growth rate was facilitated by the pent-up demand for, and lack of supply of, financial services in Bolivia's informal economy during the late 1980s and early 1990s, but it was also due to the lending technology's built-in capacity to provide financial services quickly at a relatively low cost to borrowers, and to Prodem's early investments in its own systems and human resource capacity.

By the end of 1991, Prodem was managing an outstanding loan portfolio of $4.5 million, serving a total of 22,743 clients with an average loan outstanding of $284. It had 116 employees with regional offices in the country's four major cities. Its portfolio quality was high, with a 30-day portfolio at risk of 0.18 percent and a mere $1,650 in loan losses since 1987. The institution's growth during its first five years of operation is summarized in Table 1.

Besides facilitating rapid operational growth, the solidarity group lending technology helped Prodem to build a unique relationship with its clients that was based on mutual accountability, trust and respect. This relationship was grounded in Prodem's institutional culture, but the lending technology provided an appropriate means through which the institution's cultural ideals could be put into practice. This coherence between culture and methodology was important to Prodem's institutional development and will be discussed further in subsequent chapters.

When Prodem began lending, it faced a number of conceptual obstacles. Among these were a prejudice against the informal sector and a negative

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attitude towards microlending initiatives because of previously failed credit experiments. It was generally believed that the poor did not need working capital and, even if they did, they were incapable of effectively managing a loan. Of those who believed in microentrepreneurs' ability to manage credit, many expected that the poor should not have to pay market rates for financial services because of their poverty status.

Table 1: Results from Prodem's First Five Years

	1987	1988	1989	1990	1991
Number of branches	1	1	2	3	4
Number of active clients	1,737	3,830	7,395	15,735	22,743
Number of loans disbursed this year	4,133	9,166	15,287	34,099	52,116
Value of loans disbursed this yr ($000s)	462	1,607	2,982	7,724	14,817
Average loan size disbursed ($)	112	175	195	227	284
Active portfolio at year end ($000s)	158	414	933	2,443	4,5625
Portfolio growth over previous yr (%)	n/a	161	126	162	87
30-day portfolio at risk [i] (%)	0.00	0.40	0.19	0.23	0.18
Operating self-sufficiency [ii] (%)	n/a	63	92	117	114
Financial self-sufficiency [iii] (%)	n/a	40	42	77	76
Number of employees	19	24	35	71	116
# of active borrowers per loan officer	85	316	269	367	364
Portfolio per loan officer ($)	6,990	29,791	28,793	47,156	55,315
Cost per dollar lent	1.21	0.10	0.13	0.12	0.13

Source: Prodem Financial Statements and Monthly Program Indicators

During its first five years, Prodem made significant progress in overcoming these conceptual obstacles and proved to many Bolivian skeptics that the previous paradigms about the poor and the informal sector were misguided. It showed that a significant demand for working capital by microentrepreneurs did exist, that microentrepreneurs, both men and

[i] Prodem includes in this category the total outstanding balance of any loan with a payment more than thirty days overdue.

[ii] Operational self-sufficiency is defined in this document as: financial income / (financial expense + operating expense + loan loss provision expense).

[iii] Financial self-sufficiency is defined in this document as: financial income / (financial expenses + operational expenses + loan loss provision expense + inflation adjustment + imputed cost of capital). Data on financial income, financial expense, operational expense, loan loss provision expense and inflation expense were taken from Prodem's end of year financial statements. The imputed cost of capital for each year was estimated as follows: first, the total sum Prodem spent on interest fees was divided by the total amount of funds it borrowed. This yielded an average interest rate paid by Prodem for its borrowed funds. Second, the average interest rate paid by Prodem was compared to the IMF deposit rate for Bolivia, which was used as a shadow price for the interest rate Prodem would have had to pay if it had borrowed all of its funds on strictly commercial terms. Third, the actual interest rate paid was subtracted from the shadow price. Fourth, the difference between the two interest rates, multiplied times the total amount of funds borrowed by Prodem in that year, yielded the imputed cost of capital.

women, were creditworthy, and that they were willing and able to manage loans under non-subsidized conditions. Prodem demonstrated its own ability to make institutional credit available to thousands of families who had never had access to it before, either because they could not meet the traditional banking system's requirements or because the costs of doing so were too high.[12] It also showed that it could supply services in a sustainable manner; i.e. that it could generate sufficient revenue to cover its costs. By removing many of the barriers that had inhibited the provision of microfinance in Bolivia, Prodem not only paved the way for its own expansion, but also opened the door for the participation of many more actors in the future.

The Creation of BancoSol[13]

The next stage of Prodem's development began in much the same way as the first. It grew out of a friendship between two businessmen, this time Martin Connell and Fernando Romero. Acción's Executive Director, Bill Burrus, introduced Romero and Connell in 1987. Romero was serving as Chairman of Prodem's Board and Connell was the President of Calmeadow Foundation, a Canadian NGO he founded in 1983.

Connell and Romero hit it off famously and before long the two were brainstorming ways for Prodem to expand its operations. The estimated one million owner-operated microenterprises in Bolivia provided employment and family income for up to 75 percent of the population, yet by the end of 1990, Prodem was reaching less than 3.5 percent of that potential market.[14] Since demand for its services was strong, Prodem was psychologically ready to grow, but it found itself constrained by its limited access to capital for on-lending. Even though it operated efficiently and was successful in cultivating a loyal group of donors that funded its current activities, these resources were finite and could support only minimal expansion.

Connell was among the first to recognize that Prodem's legal status most severely limited its opportunities for growth. As long as it remained a non-profit organization without private ownership, Prodem would have difficulty accessing the capital markets. Investors would find it too risky,

[12] Borrowers faced physical, emotional, financial and opportunity costs to borrowing.

[13] Much of the information included in this section was taken from Amy Glosser's essay, "The Creation of BancoSol in Bolivia," which can be found in *The New World of Microenterprise Finance*, edited by Maria Otero and Elisabeth Rhyne (West Hartford, Conn.: Kumarian Press, 1994) 229-250.

[14] Prodem, "Financial Proposal and Introductory Description for a Commercial Micro-Credit Bank in Bolivia" (La Paz, May 1990). Others have estimated the number of owner-operated microenterprises to be considerably less than one million. See Rhyne, "Mainstreaming," 19.

banks would demand unattainable levels of collateral in exchange for financing, and legal restrictions would prohibit it from accepting deposits from the public. In light of this, Connell argued that Prodem should consider creating a regulated financial institution, or a subsidiary of such an institution, that would remove some of these restrictions and give it more options for financing growth. It seemed like a far-fetched idea in the beginning, but Connell placed his organization's support behind the process of exploring it.

Burrus was thinking along the same lines and Acción had even prepared a feasibility study for creating a similar institution in Peru. Romero was immediately intrigued, although convincing the rest of Prodem's leadership that the idea merited attention proved more difficult. Clearly, it would be a risky, complicated and ambitious undertaking, but it would open up enormous possibilities for raising and leveraging funds, and for offering clients additional services. Acción and Calmeadow argued that the creation of a bank would be a major step forward in the pursuit of Prodem's mission because it would open up an avenue for massifying access to financial services in Bolivia. They believed that if Prodem could move microfinance into the formal financial sector and demonstrate its profitability, other institutions would enter the market and increase both the quality and quantity of financial services available to the poor. By adopting a market-driven approach and eliminating its dependence on donor funds, Calmeadow and Acción believed that Prodem could create a long-term economic solution to what had previously been a social problem.[15]

> *"The management and board of directors of Prodem have considered all the options available for structuring and financing future growth and have concluded that the creation of a commercial bank is the option which holds the most promise for the provision of micro-credit on a large scale in Bolivia."*
>
> – *Excerpt from the Proposal for a Commercial Micro-Credit Bank in Bolivia*

With these factors in mind, Prodem's Board agreed to launch a special team in September 1988 to study the possibility of creating a private commercial bank that would serve microentrepreneurs. In March, a preliminary version of the study was presented to the board, expressing the opinion that such an initiative was not only possible, but was also viable. In late 1989,

[15] Glosser, "Creation of BancoSol," 233.

with the financial and institutional support of Acción and Calmeadow, the board formed a separate steering committee called COBANCO (Comite Promotor del Banco para la Microempresa) that was responsible for transforming Prodem's lending operations into a commercial bank. The committee existed for two years and four months and spent nearly $560,000 making BancoSol a reality.[16]

COBANCO tackled three main tasks: 1) raising the necessary capital; 2) fulfilling the legal and technical requirements for entry into the formal financial sector; and 3) demonstrating operational capability to the Superintendent of Banks and Financial Institutions.[17]

To satisfy Bolivian Government guidelines for incorporation as a bank, COBANCO had to raise at least $3.2 million in equity. Early feasibility studies envisioned that this funding would come from concessionary loans and donations, but by the fourth and final study, it was decided that the bank would be constituted on purely commercial terms. Its $5 million in initial equity was ultimately raised from three types of sources: Prodem's loan portfolio (35 percent), foreign institutions (46 percent), and Bolivian institutions and individuals (19 percent). The total sum was $1.8 million more than the minimum required.[18]

Raising the required capital was hardly easy, but it was a walk in the park compared to the process of fulfilling the legal and technical requirements for incorporation as a bank. COBANCO had to elaborate a feasibility study and business plan that could convince the Superintendent's office that the bank would generate a positive return within three years by providing credit to a non-traditional clientele using a lending methodology that lacked traditional guarantees. COBANCO met this challenge largely because of Prodem's successful track record, and because influential businessmen, politicians and institutional investors lobbied for the proposal on Prodem's behalf. The care with which Prodem assembled its board and cultivated transparent relationships with its donors and technical partners was key in enabling these strategic actors to support Prodem in accomplishing its goals.

To demonstrate that it was capable of operating as a bank, Prodem had to develop new reporting, taxation and security systems, design additional computer software, train its staff, and in general, formalize its operating procedures to conform with regulatory requirements. Prodem began

[16] Glosser, "Creation of BancoSol," 242.

[17] Rachel Rock, "Bolivia," in Regulation and Supervision of Microfinance Institutions: Case Studies, edited by Craig Churchill, Occasional Paper No. 2 (Toronto: The Microfinance Network, 1997) 50.

[18] Rock, "Bolivia," 50.

preparing for these changes well in advance of BancoSol's opening. When the decision was made to create a bank, Prodem took over the teller operations from the two banks it had been contracting to provide these services. This enabled it to offer better service to its clients and gave it time to devise systems, train personnel and prepare teller operations for BancoSol's launch. Prodem designed a series of seminars for all staff aimed at increasing their skill levels since most of the bank's employees did not have any experience working in a regulated financial entity. Prodem also invested substantially in the ideological and psychological aspects of the transition. Two-day transition seminars were held for all personnel to explain why the NGO decided to convert its lending operations into a bank. Many employees were uncertain and some were hostile about the idea of becoming employees of a for-profit institution. The transition seminars played a vital role in helping Prodem's leadership build consensus around its decision.[19]

In March 1991, COBANCO submitted the necessary documentation to the Superintendent for incorporation of the bank. In October it received BancoSol's charter and was given ninety days to prove the bank was ready to commence operations. By January it had met this requirement and on February 1, 1992, the Superintendent gave BancoSol the authorization to begin operations.

The Prodem/BancoSol Symbiosis

When the decision was made to create BancoSol, Prodem's Board necessarily questioned whether the foundation should continue to exist after the transition. If its lending activities were to be taken over by BancoSol in a commercial manner, was there any reason for the NGO to continue providing credit? Should it reorient itself to providing some other service for microentrepreneurs? Or should it be closed?

Although Prodem's future objectives were far from clear in the early stages of the transformation, by 1990 it was decided that Prodem should not close, but rather, should dedicate itself to one or more of the following activities:

1) Developing methodologies for lending in rural and secondary cities where microcredit programs had not yet been proven sustainable;

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[19] W. Fischer, Jeffrey Poyo, and A. Beasley, "Evaluation of the Micro and Small Enterprise Development Project in Bolivia," Technical Report No. 42 (Bethesda, Maryland: GEMINI, 1992) 10.

3) Researching and developing new financial products and/or training services for the microenterprise sector;
4) Providing support services for BancoSol in areas such as staff development, borrower orientation or periodic socio-economic evaluation.

The new bank would need to devote itself strictly to banking functions to be commercially viable. It could not assume the development risk inherent in meeting other needs of the informal sector. The NGO, however, could perform development tasks from which both the bank and the informal sector could benefit. Thus, very close ties were initially envisaged between the two institutions, even though the details of their cooperation were unclear.

Once BancoSol opened its doors, pressure was placed on both institutions to define a transparent relationship that avoided passing subsidies from one entity to the other. Donors did not want to support an NGO that was providing special benefits to a commercial entity, and investors did not want to support a bank that was not commercially viable.[illegible] Prodem began to question its ability to perform research and development activities for the bank when it lacked day-to-day access to the bank's clients, and when its NGO status prohibited it from experimenting with many of the services it would have liked to test.

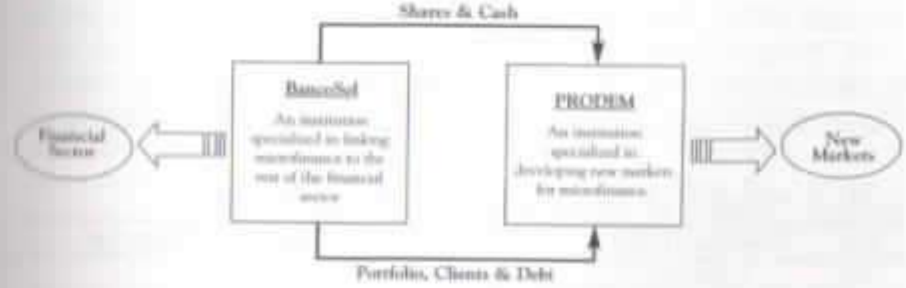
Because of these and other factors, Prodem decided to focus on only one of the three activities described above: expanding microlending to the rural areas and secondary cities of Bolivia. It planned to gradually transfer its existing lending operations to BancoSol while it initiated new operations in outlying areas. If it succeeded in making a new technology, branch or service profitable, it would sell that asset to the bank at some agreed upon percentage above book value to compensate for its research and development costs, and use the revenue to finance its continued activities.

In this way, a symbiotic relationship developed between BancoSol and Prodem. Each organization had an interest in working with the other because it believed the relationship would be mutually beneficial and nourishing over time. BancoSol would receive an initial transfer of clients and portfolio from Prodem that would guarantee it an immediate source of revenue, an experienced and highly motivated staff, and an infrastructure base from which to expand future operations. It could then look forward to future transfers of technology and operations at a fair cost without having to assume any development risk. Prodem would receive shares in the bank in exchange for the initial transfer and would receive dividends on those shares just like any other investor. It would be free to pursue its institutional mission by moving into more isolated areas of Bolivia, believing that if it succeeded in developing a service that met the financial needs of borrowers in those areas, BancoSol would provide a channel for massifying that service.

[illegible] Calmeadow, "Prodem: Institutional Strengthening and Diversification," Inception Report (Toronto, November 1993) 5.

This symbiotic model, depicted in Figure 2 , was seen by microfinance institutions around the world as an innovative and exciting way to capture resources from the formal sector and direct them toward the informal sector, linking the two sectors in the process.

Figure 2: The Symbiotic Model



Because of their symbiotic relationship, BancoSol and Prodem had a mutual interest in effectively managing the transfer of operations from one institution to the other, and indeed, worked well together between 1992 and 1994 to create a solid foundation for the bank. Overlapping board members and investors made it possible for the two institutions to coordinate their strategies and resolve potential conflicts. Pancho Otero served simultaneously as the Executive Director of Prodem and the CEO of BancoSol for eight months before moving to the bank full time. His leadership, together with the fact that BancoSol's staff, clients and methodology all had Prodem roots, facilitated the transition. Policies and procedures were coordinated, and a single human resources department hired and trained staff for both institutions.

The transition began with the first transfer of Prodem's portfolio to BancoSol on February 1, 1992. A \$2.1 million portfolio, \$400,000 in other assets, and \$1.9 million in debt from Prodem's La Paz branch were assumed by the bank.[21] In exchange, Prodem received approximately $600,000 in BancoSol shares, an amount that represented the difference between the value of the assets transferred and the associated liabilities. This transition continued over the next 15 months, resulting in the transfer of Prodem's four original branches, 134 staff, more than 25,000 clients and a $5.8 million portfolio to BancoSol. The conversion was implemented in stages to ease the process. Transferring branches one at a time involved fewer people and fewer transactions; it allowed for more adequate training of personnel and the testing of new software in each office; and it enabled BancoSol to improve the process over time using lessons learned from earlier transfers.

Prodem began opening new branches in secondary cities and in rural areas of the country in 1992 with the intention of transferring the new branches to BancoSol once they had become sustainable. By the end of 1994, Prodem had opened 22 new branches, four of which had been transferred to the bank (see Table 2). The symbiotic model was working, and seemed to validate the equation "Prodem + BancoSol = massification."

Table 2: Summary of Transfers from Prodem to BancoSol

Year	Portfolio (US$)	Clients	Staff	Branches
1992	4,695,604	21,569	96	3
1993	1,106,513	4,188	38	1
1994	2,528,894	8,411	50	4
Total	8,331,011	34,168	184	8

Source: Prodem, *"Twelve Years Promoting and Developing the Microenterprise Sector"* (La Paz, 1998) 20-1.

Changing Track: Prodem Reinvents Itself

Having succeeded in creating the country's largest urban microfinance program and then transforming that program into a commercial bank, Prodem found itself facing a different challenge: to start all over again—this time in rural areas.

When Prodem made the decision to enter Bolivia's rural areas, it was not the first to do so. A few NGOs and a weak credit union system were already operating in certain parts of the country, but not in a sustainable

[21] Prodem, "Plan de Transferencias o Venta de Cartera de Prodem a BancoSol" (La Paz, no date).

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way or on a significant scale. Three government banks were present in the rural areas until 1991, but two were shut down and one withdrew without leaving any particularly successful or efficient model behind.[22] Prodem estimated that 90 percent of the rural population was employed in the informal sector and believed it could serve this market, but knew it would not be an easy task. With a population density of just two inhabitants per square kilometer, a weak infrastructure, shallow economies, socio-cultural and language barriers, and a history of government loan forgiveness, Bolivia's rural areas provided a difficult environment for microlending.[23] Reorienting its operations to serve borrowers in that environment would be riskier and more expensive for Prodem than its urban microlending program had been, particularly since it had no international model to replicate and would have to design its own way forward.[24]

There were three components to Prodem's process of reinventing itself: operational, structural, and institutional. From an operational perspective, Prodem needed to familiarize itself with the rural environment, design an appropriate methodology, and adapt its structure and systems to support the selected methodology. Its strategy for achieving these ends required immediate and complete immersion. In May 1992, when the transfer of portfolio to BancoSol had just begun, Prodem opened its first rural branch in Achacachi, 130 kilometers north of the capital, La Paz. It designed its new methodology through a process of trial and error, starting with the model it knew best. Its first loans were structured and delivered using essentially the same technology used in the BancoSol branches.

Almost immediately, Prodem began to learn which elements of its product and delivery did not meet client needs and it adapted the methodology accordingly. It learned, for example, that the rural market demanded, and indeed could sustain, longer initial loan terms and higher loan amounts. New evaluation forms were developed to analyze the different types and product cycles of rural enterprises. Largely as a response to the information gained from this new type of evaluation, Prodem introduced a new payment schedule in 1994. Rather than require each group to repay its loan in equal installments, it became possible for a group to structure its payment plan according to its cash flow, paying interest only in certain months and interest plus capital in others.

[22] The Banco Agricola and the Banco Minero were closed in 1991 and the Banco del Estado was restructured. See David Lucock, "The Costing of Rural Financial Services in Bolivia" (Washington, DC: Development Alternatives, Inc., July 1993) Attachment A-1.
[23] Prodem, "Welcome to Prodem," Presentation,1998.
[24] Success stories such as those of Grameen Bank and Bank Rakyat Indonesia were inspirational for Prodem but were of limited utility since they were developed in a rural environment with a significantly more dense population.

Structurally, Prodem discovered that its infrastructure requirements at the branch level were too onerous and needed to be streamlined. Rather than provide each branch with an accountant, a systems manager and a chauffeur (as was the case in urban offices), it gave loan officers responsibility for all branch activities and they rotated tasks among themselves to provide internal control and continuity. In mid-1993, Prodem established a Systems Department independent of BancoSol and completely rewrote its loan portfolio and accounting software so it could be more easily managed in the field. Prodem conducted research into telecommunications that would improve the efficiency and reduce the costs of sending information between agencies, regional offices and the head office. By 1994, Prodem also began testing alternatives to the full-time agency model of service provision. It experimented with mobile operations and credit outlets that were open only on market days.

Prodem faced a steep learning curve with respect to the reorientation of its activities towards the rural areas, but its most difficult challenges during this period were institutional. As it emerged from the creation of BancoSol with a small staff and limited fixed assets, Prodem struggled with an identity crisis and a weakened spirit. Staff that had not been invited to transfer to BancoSol, either because they lacked skills or because it was felt they would be more effective helping Prodem enter its new phase, in many cases felt rejected and demoralized. They were sent to rural areas far from their families and friends with dilapidated furniture and equipment that BancoSol did not want, and they were asked to start re-building an institution largely from scratch. At the time, Prodem still lacked clarity with respect to its new mission and its relationship with BancoSol. Its plans for the future were almost totally eclipsed from the public eye by the exciting but immense shadow of BancoSol.

Prodem's first major step in confronting these institutional challenges was the consolidation of a new management team. In November 1992, Sergio Prudencio and Jaime Burgoa came on board as Prodem's new Operations Manager and Finance Manager. In February 1993, Eduardo Bazoberry, the former Manager of Operations and Finance, was asked to serve as the new Executive Director. Miguel Lopez was hired as the new Systems Manager in April.

This new team took Prodem's second major step towards rebirth by defining a 6-year plan for institutional strengthening and diversification, which included the research and development of new lending methodologies and other financial services for the informal sector, strategies for the expansion of operations and the attainment of self-sufficiency, investments in infrastructure development, and impact

analysis. The plan was designed with the assistance of Calmeadow and its implementation was funded in part by a C$4 million grant from the Canadian International Development Agency, awarded in July 1993. Loans from the Inter-American Development Bank and Funda-Pro, a private Bolivian foundation that provided second-tier lending services, also supported Prodem during the first two years of the plan's implementation.

These initial steps created significant momentum, and by the end of 1994, Prodem could report progress on many fronts (see Table 3). It had hired and trained more than 200 new employees. It had opened 22 new branches: six in secondary cities, three in semi-urban areas, and 13 in rural areas. Despite the increased cost of lending in these areas and the significant client, staff and portfolio transfers made to BancoSol, Prodem kept arrears low throughout the period and its branch network regained its operational self-sufficiency. As an institution, Prodem also achieved financial self-sufficiency thanks to its participation as a shareholder in BancoSol. By the end of 1994, it was clear that Prodem had succeeded in reinventing itself, but it was not yet certain that its new rural focus would be sustainable.

Table 3: Results of Prodem's Rural Reorientation[23]

	1991	1992	1993	1994
Active clients (Dec 31)	22,743	7,622	12,221	9,974
Clients transferred to BancoSol that year	0	21,569	4,188	8,411
Number of employees (Dec 31)	116	59	112	128
Employees transferred to BancoSol that yr	0	96	38	50
Number of branches (Dec 31)	4	7	11	18
Major urban areas	4	1	0	0
Secondary cities	0	2	3	4
Semi-urban areas	0	2	2	1
Rural areas	0	2	6	13
Branches transferred to BancoSol that year	0	3	1	4
Active portfolio at year end ($000s)	4,562	2,178	3,660	2,597
Portfolio transferred to BancoSol ($000s)	0	4,696	1,107	2,529
30-day portfolio at risk (%)	0.18	0.67	0.85	0.83
Operating self-sufficiency (%)	114	99	94	126
Financial self-sufficiency (%)	76	84	79	112
Active borrowers per loan officer	364	260	172	212
Outstanding portfolio per loan officer ($)	55,315	49,087	47,545	55,360
Average loan ($)	284	286	300	260

Source: Prodem Financial Statements and Monthly Program Indicators

[23] Negative growth in certain indicators is explained by the significant client, staff and portfolio transfers noted in Table 2.

Growth and its Effects

Having established itself as a rural microlending institution, Prodem entered a growth phase in 1995. Growth was driven by two main factors: 1) an internal desire to broaden access to financial services in underserved areas of the country; and 2) the external competition emerging in areas where Prodem already operated. The combination of these factors led Prodem to expand its lending operations as quickly as possible while simultaneously developing new products and delivery mechanisms that could respond to its clients' changing needs and desires.

Prodem's strategy during this period was straightforward. It fueled its growth through a policy of aggressive branch expansion, an increase in the maximum initial loan amount, methodological innovations that enabled more efficient delivery of its solidarity group product, and the introduction of an individual loan product. As a result of these initiatives, Prodem's portfolio grew 73 percent in 1995, 83 percent in 1996, and 121 percent in 1997. In those three years, it quadrupled the number of active clients, increased the average loan size from $339 to $505, and opened 23 new branches (see Table 4).

Table 4: Prodem Statistics 1995-1998

	1995	1996	1997	1998
Number of active clients	18,309	27,484	38,248	47,130
Number of employees	134	161	237	309
Number of branches	27	33	40	50
Main urban areas	0	0	4	4
Secondary cities	5	7	6	9
Semi-urban areas	2	4	8	12
Rural areas	20	22	22	25
Active portfolio at year end ($000s)	4,517	8,284	18,280	24,188
In main urban areas (%)	0	0	19	15
In secondary cities (%)	45	44	33	31
In semi-urban areas (%)	4	9	14	19
In rural areas (%)	51	47	34	35
30-day portfolio at risk (%)	0.09	0.96	0.72	2.82
Operating self-sufficiency (%)	108	165	157	138
Financial self-sufficiency (%)	92	135	111	117
Cost per US$ lent	0.18	0.12	0.10	0.15
Active borrowers per loan officer	226	267	306	287
Outstanding portfolio per loan officer ($)	55,760	80,430	146,242	147,488
Average loan ($)	337	386	505	571

Source: Prodem Financial Statements and Monthly Program Indicators

The challenge for Prodem during this period was to manage its growth. It endeavored to meet this challenge through a variety of initiatives. It held annual and quarterly strategic planning sessions. It evaluated field staff to assess their understanding of Prodem's methodology and the quality with which they were implementing it. It made adjustments in its information systems to monitor individual branch progress towards self-sufficiency and to compare the results from one branch to others in a similar market. It also carried out market studies to deepen its general knowledge of rural financial markets, client cash flows, and the effectiveness of its current methodology in satisfying client needs.

In 1995, Prodem integrated its institutional and human resource development efforts by creating a Department of Organizational Development. The new department played a critical role in identifying and rectifying institutional weaknesses. Then, in 1997, Prodem introduced a new level of regional management into its organizational structure and gave managers at that level a great deal of autonomy in their decision-making. This move substantially improved the guidance and oversight provided to individual branches and increased the flexibility with which Prodem could respond to each region's operational needs.

Together, these initiatives enabled Prodem to manage its growth while keeping costs and arrears low. Loan officer productivity increased throughout the period, both in terms of the number of clients served and the size of the portfolio managed, yet the institution's 30-day portfolio at risk remained below one percent. At the end of 1997, 95 percent of Prodem's branches were covering both their local costs and their allocation of regional and head office costs; 78 percent were also contributing their full allocation of real financial costs. The institution as a whole was covering all of its operational and financial costs, including a 13.4 percent imputed cost of capital.

The initiatives to manage growth provided Prodem with more than just the capacity to expand; they also enhanced its capacity to respond quickly when performance began to weaken. During the second half of 1996, arrears began to rise. Although they never reached alarming levels, the trend was disturbing, particularly since it was accompanied by stagnation in the institution's portfolio and client base. During the first six months of 1997, Prodem's portfolio contracted by one percent and its client base grew by a mere 2 percent when, during the same time period of the previous year, its portfolio and client base had grown by 35 and 32 percent respectively.

By the end of 1997, national management's attention was divided among forty different agencies across eight out of nine of Bolivia's provinces.

In late 1996, Prodem hired a Bolivian firm, Impulso SRL, to conduct a market research study at a national level in both urban and rural areas. Together with Prodem's methodology review and other ongoing initiatives, the study helped determine several possible sources for the stagnation and arrears: client dissatisfaction with the solidarity group lending methodology, high levels of client desertion in some branches, increasing competition that put pressure on staff and pricing, and an overestimation of the market potential in certain areas.

With this information, Prodem took several actions to respond to the situation. It redesigned its solidarity group product by introducing personalized repayment schedules for group members based on each client's cash flow and repayment capacity. It lowered interest rates in competitive markets, expanded the availability of its individual loan product to all branches, and targeted new branch openings in urban and secondary cities only, since most of the problems were concentrated in rural areas.

The market's response to these initiatives was overwhelming. In 1997, Prodem's portfolio grew 121 percent and the number of active clients increased by 39 percent. These year-end figures completely masked the challenges posed to the institution earlier in the year. They also hid a growing portfolio quality problem that by mid-1998 would cause Prodem's leadership to take a step back once again and analyze the situation.

This time, they found arrears concentrated in select agencies, most of which were urban. The rapid shift of portfolio from rural to urban areas coincided with the opening of several urban branches in major cities with field staff who had either recently joined Prodem or had been recruited from rural branches and were not yet experienced in judging the character of urban borrowers, who were more credit savvy than most rural clients, and in many cases, already heavily indebted. Prodem's portfolio shift also coincided with the emergence of fierce competition in urban areas, not just among NGOs but from private financial funds, cooperatives, commercial banks, and consumer credit operations as well.

Prodem realized that it needed to pursue slower growth and implement tighter controls. In the short term, it worked to consolidate its operations and developed a strategy for resolving the arrears problem. It updated its procedure for opening new branches so that it incorporated greater analysis of the potential market, existing infrastructure, and competition. It also refocused its expansion on rural areas, now that reforms had been implemented successfully in its solidarity group product. In the medium and long term, however, Prodem realized that its environment, its clients and its competition were driving it into another phase, one that would require it to develop new strategies for capturing market niches rather than attempt to compete in already saturated markets.

The Symbiotic Model Breaks Down

Although Prodem and BancoSol worked well together during the initial transfer of branches, the relationship between the two institutions began to weaken just a year after the bank was created.

Having realized that its rural operations required an information infrastructure that was fundamentally different from that maintained by BancoSol, Prodem established its own Systems Department in May 1993, a move that made it more difficult for the two institutions to share information. In 1994, the joint Human Resources Department also began to split as BancoSol and Prodem developed increasingly distinct priorities for their recruitment, training and staff development programs. The bank, for example, sought employees with strong financial backgrounds and wanted to stress issues of accountability and control in its ongoing training, while Prodem sought staff who could speak local languages such as Quechua and Aymara and wanted to stress motivational issues in its ongoing training. The different objectives of the two institutions eventually led Prodem to create its own Human Resources Department in 1995.

The splitting of these Departments decreased the operational ties between BancoSol and Prodem and contributed to the growing separation of the two institutions. Fernando Romero had resigned as chairman of BancoSol's board in 1993 in order to assume a cabinet post in the new Bolivian government. With his departure, Prodem's influence on BancoSol's governance declined. Rivalry between Otero and Bazoberry also created distance between the institutions.

A prominent Bolivian businessman and banker, Julio Leon Prado, took over from Romero as chairman of BancoSol and began to guide the bank in a more commercial direction. Having expanded rapidly during its first three years of operation, BancoSol decided in 1995 to consolidate its existing network of branches and build additional management and systems capacity before growing further. Believing it would not be beneficial to buy Prodem branches during this period it requested a temporary halt of the transfer of agencies until 1997. For Prodem, the suspension provided the opportunity to focus more intensely on opening branches in rural areas rather than secondary cities, since rural operations took longer to become sustainable.

The symbiotic relationship between BancoSol and Prodem was officially kept intact during the suspension, but unofficially, it was already mortally wounded. For the relationship to have remained mutually beneficial, the transfer of agencies would have had to resume at a pace and with a strategy that made sense to both institutions. Yet, the suspension of agency transfers had the unintended consequence of encouraging BancoSol and Prodem to develop on independent trajectories, so that a common pace and strategy were never again found.

> *"Growth changes things."*
>
> *- Jose Becerra, Manager, Department of Organizational Development*

From 1995 to 1997, BancoSol pursued a policy of consolidation and vertical growth.[27] It hired a new General Manager from the traditional banking sector, Hermann Krützfeldt, who had a more conservative philosophy than his predecessor. He steered BancoSol away from geographic expansion, particularly in rural areas where operations were undeniably riskier.

During the same period, Prodem pursued a policy of aggressive horizontal growth and institutional strengthening, which resulted in the creation of a mature and independent institution with a five-year plan that continued to focus on expansion. By the end of 1996, Prodem anticipated that it would need nearly $10 million to finance its next three years of growth and it saw only two realistic options for obtaining this financing: 1) by selling a large number of branches to BancoSol; or 2) by incorporating as a Private Financial Fund (Fondo Financiero Privado, or FFP).

In many respects, Prodem found itself in a situation similar to that of 1989, when its legal status as a non-profit foundation made it impossible to raise the funds necessary for its future growth and led to the creation of BancoSol. Prodem had little desire to put itself through another conversion process, but given the deteriorating relationship with BancoSol, felt this was the only alternative. The FFP legal entity had recently been created by the Superintendent in response to BancoSol's trailblazing and the recognized need to provide a more appropriate vehicle for regulating microfinance institutions.[28] This new legal form provided Prodem with an option for acquiring the status of a regulated financial institution without becoming a full-fledged commercial bank. As an FFP,

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[27] The term "vertical growth" refers to growth that is concentrated in an institution's existing structure, i.e. established branches increase their client or portfolio base, or introduce new products. "Horizontal growth" refers to growth that results from the expansion of an institution's existing structure, i.e. the opening of new branches.

[28] The FFP legal entity was created by the Bolivian Superintendent of Banks and Financial Entities in 1995. It has lower initial capital requirements than a bank and is thus prohibited from providing certain financial services, but it can offer savings accounts and time deposits.

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"Growth changes things."

- Jose Becerra, Manager, Department of Organizational Development

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it would be able to accept deposits from the public and have easier access to inter-bank loans, two important sources of financing.

In 1997, when BancoSol and Prodem should have resumed collaboration, the path forward was not as clear as it had been in 1993. The institutions now possessed different growth strategies, different priorities, and different timetables for arriving at their goals. Prodem was ready to transfer at least ten branches to the bank and wanted to do so quickly to finance its future growth. BancoSol no longer considered the purchase of many Prodem branches as a desirable expansion strategy. The bank offered to buy a few select branches, but this option was undesirable to Prodem since it worked against the goal of building a sustainable rural network and could undermine Prodem's own institutional viability. Prodem had developed its rural branches in clusters, each of which was profitable. If BancoSol were to purchase only the most successful branch from each cluster, the remaining units would not be sustainable.

The deteriorating nature of the relationship was revealed most clearly by a disagreement over the valuation of the assets Prodem was offering for sale. BancoSol and Prodem simply could not agree on a mutually acceptable price. Each institution placed a value on the assets and neither "needed" the other so badly that it was willing to accept what it believed was an unfair price just to maintain the partnership. "Better," so the saying went, "to go it alone."

Interdependence rapidly gave way to competition. As transfers continued to stall and the relationship between the two institutions became more contentious, Prodem began to pursue incorporation as an FFP, and the leadership of both institutions tried to resolve their breakdown in cooperation. Two options for the future emerged.

One subset of the Prodem/BancoSol leadership, most notably those who held stakes in both institutions, was alarmed by Prodem's pursuit of its FFP status. This group saw great value in a continued relationship between Prodem and BancoSol and considered the creation of an FFP as a less than optimal solution to the dilemma. The transition process would be expensive, it would duplicate resources, it would turn allies into competitors, and it would deny both institutions the benefits of their combined economies of scale. This subset proposed a merger of Prodem and BancoSol to take advantage of what it saw as a unique opportunity to create a national microfinance infrastructure with unparalleled market penetration.

The other subset of the Prodem/BancoSol leadership felt it would be best for the two institutions to go their separate ways. Each had become a strong, profitable institution providing a valuable service in a distinct market with a distinct strategy. This subset believed the resulting competition would greatly strengthen the microfinance sector in Bolivia and ultimately offer a better deal to clients. The prospect of building a national microfinance institution was attractive, but the merger was considered too risky. The process of integrating such different cultures, management styles and information systems, among other things, would be difficult and would take years to accomplish. The members of this group were not at all certain that the benefits of a merger would outweigh its costs.

To facilitate discussion between these two subsets, Calmeadow proposed and ultimately arranged for a study to be undertaken by an independent third party to assess the costs and benefits of the two options. The goal was to put an objective document on the table with numbers and facts that could help the group make an informed decision. Toronto Dominion Securities, a Canadian investment banking firm, conducted the study on a pro bono basis and, in January 1998, submitted a report which concluded that the value of a combined entity would be significantly greater than the value of two stand-alone competitors. Despite the report, the BancoSol/Prodem leadership voted against a merger and the two institutions went their separate ways in March 1998.

Why was this decision taken? Each person who participated in the discussion has a different perspective on the answer. Essentially, the Toronto Dominion report analyzed the "real" costs and benefits of the two options, but not the costs and risks of the two options as perceived by the various actors involved. Many of the decision-makers had personal and/or institutional agendas, prejudices and priorities that influenced their assessment of the process and their participation in it. Most felt there was much more at stake than an objective analysis of the situation would suggest.

Power struggles also made it difficult for cooperation to be realistically considered. There was a great risk that the merger would not be managed in a way that would enable all parties to reap its benefits, and no one wanted to be left holding the short end of the stick. It was difficult for stakeholders to accept this risk given the positive status quo. Both Prodem and BancoSol were performing well and had promising strategies for future growth. Their owners controlled at least some piece of a profitable pie, and accepting a merger would have meant risking the loss of that control.

The breakdown of the symbiotic model was a complex and in certain respects painful process. Some stakeholders were frustrated by what they perceived to be a lost opportunity of historic proportions. Others were satisfied that their best interests and the best interests of both institutions were safeguarded. What no one denies is that Prodem came into its own as a result of the process. In October 1998, it submitted its application to become a Private Financial Fund, and in November it sold 43 percent of its shares in BancoSol to change its position from a majority to a minority shareholder. Prodem relinquished its seat on BancoSol's board, and with it, virtually all control over BancoSol's future decision-making.

Towards a Private Financial Fund

Prodem began the FFP application process from a fairly strong position. As of December 31, 1998, its outstanding portfolio of $24 million had a 30-day portfolio at risk of 2.8 percent. The institution was completely self-sufficient, taking into account inflation and loan loss expenses as well as the imputed cost of capital, and it produced a return on assets of 10.2 percent. As shown in Table 5 , it was delivering microcredit at a scale achieved by few other institutions at the time.

Table 5: International Performance Comparison 1998

Indicator	Prodem [a]	BancoSol [b]	Average of 14 other Bolivian MFIs [b]	Average of 10 Large Latin American MFIs [c]	Average of 32 Fully Sustainable MFIs [c]
Active portfolio ($000s)	24,188	74,068	7,897	17,222	8,144,127
Active borrowers	47,130	81,555	14,882	27,420	15,632
Average loan balance ($)	513	908	531	714	509
Unadjusted ROA[*]	10.2%	4.2%	3.9%	5.5%	8.4%
Age of institution (years)	12	8	8	11	9
Financial self-sufficiency	117%	n/a	n/a	116%	111%
Operating expense ratio[*]	26%	23%	n/a	27%	32%
Number of branches	50	45	13	20	13
Borrowers per staff member	153	n/a	n/a	119	126

a Source: *Prodem financial statements for December 31, 1998.* b Source: *Boletín Financiero Microfinanzas, N°3, April 1999.* c Source: *MicroBanking Bulletin, July 1999.*

[*] Throughout this document, the unadjusted return on assets is defined as: net operating income / average total assets

[*] Throughout this document, the operating expense ratio is defined as: (financial expense + loan loss expense + inflation expense + administrative expense) / average total assets

Its loan portfolio and client base were nearly three times as large as the norm for sustainable microfinance institutions and its branch network was more than four times as broad. It was more profitable than the average sustainable MFI despite having an almost identical average loan balance. It was also more efficient. Its operating expense ratio was lower than average, even for its Latin American peers, and its staff productivity was significantly higher. This was particularly impressive given that most Latin American MFIs operated in urban areas where it should have been easier to be productive and efficient. Even at the national level, Prodem distinguished itself as one of the most influential microfinance institutions in the country. It had the largest portfolio and served more clients than any other microfinance institution operating in Bolivia's rural areas.

In many respects, the process of creating an FFP was familiar to Prodem since many senior managers were involved in transforming Prodem's urban lending program into BancoSol. The experience gained during that transition greatly enhanced the present leadership's ability to guide Prodem through a second transformation.

In preparation for the conversion, Prodem implemented changes, such as creating internal audit and treasury departments. It hired a new finance manager, Marcello Maella, who had worked for the Banking Superintendent and helped draft the FFP legislation. Prodem invested significantly in the development and testing of new products that could be offered once the license was approved. It designed a new SQL-based information system that could incorporate those new products while offering additional security, speed and reporting features. Among other things, it also enhanced the institution's image by designing a new logo and standardizing the presentation of its branch offices across the country.

As was the case in the creation of BancoSol, the most difficult element of the preparation was the development and marketing of the feasibility study that outlined the future structure and strategy of the Private Financial Fund. With technical assistance from Calmeadow and support from local data collection experts, Prodem analyzed its current market position, its competitive advantage, and the potential demand for new financial products. With this information, it created a multi-year financial projection with detailed capital budgets, staffing, and financial and portfolio projections for each of its branches. It also created an offering memorandum to market the FFP to potential investors. The memorandum used both the research and projections to present the FFP's business plan and demonstrate its viability.

Once Prodem's Board officially decided to convert the NGO's lending activities into a Private Financial Fund, the process moved quickly.

Prodem completed its feasibility study and submitted an FFP application to the Superintendent just six months after deciding to proceed in this direction. Because of its phased-in plan for recruiting private investment, and the fact that it had been building relationships with potential investors for quite some time, Prodem was able to amass $4.7 million of paid-in capital for the new FFP, four times the amount required by Bolivian law. Private investors committed $1.3 million, or 28 percent of the total, and the NGO committed the remaining 72 percent.

Marketing the transition internally was an important but relatively straightforward process. Partly because of the institution's culture, and partly due to the steady and constant flow of information from management, the staff was mentally prepared for and saw the value inherent in making a change. With several examples of formalized microfinance institutions to learn from, and with competition increasing throughout the country, staff recognized that the FFP status would permit the organization to diversify its funding sources and its services. They knew the transition would be a challenge, but believed it would provide new opportunities for the institution, for themselves, and most importantly, for clients.

"It is often not change itself, but the shock of the unexpected and the fear of the unknown that create resistance. A lot depends on the message that is sent before a change."

- Daysi Orosco, Branch Manager

In April 1999, six months after it submitted its application, Prodem was given permission to constitute an FFP. It spent the rest of 1999 fulfilling the legal requirements necessary to obtain its operating license, and consolidating its operations in preparation for the FFP's launch.

Prodem's greatest challenge in the consolidation of its operations was delinquency management. The cumulative effects of Bolivia's economic recession, unfavorable climatic conditions, border restrictions, and over-indebtedness made it increasingly difficult for clients to repay their loans on time. Prodem's 30-day portfolio at risk rose to 6.9 percent by the end of October 1999, with the contaminated portfolio in some branches reaching more than 30 percent. While hardly surprising given average commercial bank arrears during a similar period of 6.6 percent, the trend caused the institution's leadership to place severe restrictions on new lending, particularly in problematic branches, and to design an entire campaign to resolve the delinquency problem before transferring portfolio to the FFP.

Prodem worked hard, together with its clients, to find solutions to their repayment problems. Many clients eventually repaid their loans, but others wanted to pay and could not. Prodem believed that the majority of these borrowers were in a temporary period of difficulty. As long-time participants in the informal sector, they had already proven themselves to be resilient and resourceful and would no doubt adapt to the new economic environment. To allow them the time to do so, Prodem rescheduled loans for the first time in its history. By the end of 1999, it had rescheduled 5.9 percent of its portfolio according to strict guidelines. With the minority of clients who showed no willingness to repay their debt, Prodem applied strong pressure, ultimately taking them to court or, when relevant, repossessing collateral.

The cost of these efforts was significant. Loan officers spent the majority of their time and energy in 1999 collecting rather than disbursing funds. Legal and provisioning expenses increased. The portfolio shrank by 10 percent for the year, and income fell as a result. Despite the considerable challenges, Prodem managed to cover its costs in 1999, including the cost of inflation and the imputed cost of capital. It also remained the largest microcredit provider in rural Bolivia in terms of the size of its portfolio and in terms of geographic outreach, although not in terms of the number of clients served.

On Friday, December 31, 1999, Prodem Oportunidad, FFP received its operating license, and on Monday, January 3, 2000 it began operations. The Prodem Foundation laid off the vast majority of its staff, who were subsequently hired by the FFP, and it transferred the administration of its portfolio to the FFP. Until the end of May 2000, the Foundation paid the FFP a commission for the management of its active portfolio equal to 95 percent of the interest fees collected. The FFP returned 100 percent of the loan capital recovered to the Foundation on a monthly basis. For its delinquent portfolio, the Foundation paid the FFP a commission equal to 60 percent of the loan capital and interest recovered. On June 1, 2000, the Prodem Foundation sold its remaining portfolio net of provisions to the FFP for $5,620,705.

An Auspicious Beginning?

It was hoped that by launching its activities on the first business day of the new millennium, Prodem Oportunidad, FFP would get a fresh start, but the already poor economic situation in Bolivia only worsened. As the recession deepened, so did clients' repayment problems. In September, political conflicts resulted in strikes and blockades that nearly paralyzed the country, making it impossible for most rural microentrepreneurs to get their goods and services to market. Debtor associations lobbied in favor of debt

forgiveness and loan reprogramming. Arrears rose. Among the 28 microfinance institutions in Bolivia, portfolio-at-risk averaged 12.2 percent at the end of 2000; among banks, the rate was nearly as high, at 11.6 percent.[11] Local economists predicted that the economic situation would not improve until at least 2002.

The environment gave Prodem Oportunidad, FFP an acid test during its very first year of operations. How did it fare?

Figure 3: Unadjusted Return on Assets, BancoSol and FFPs, Dec 2000

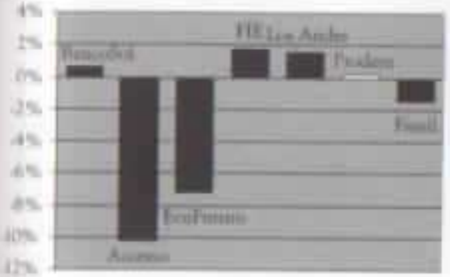
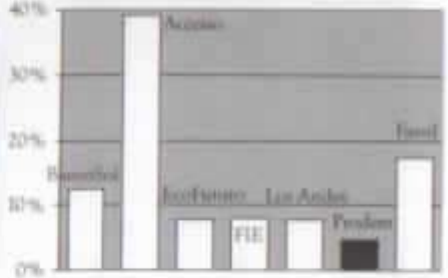


Figure 4: Portfolio at Risk, BancoSol and FFPs, Dec 2000



All things considered, it fared well. Figure 3 and Figure 4 illustrate that although Prodem was not the most profitable institution in 2000, it managed to keep its nose above the water and lowered its portfolio-at-risk to just 4.8 percent of its gross portfolio. It remained a serious competitor in the Bolivian microlending market, even though it was not the leader in that market, as shown in Figure 5 and Figure 6. An attempted merger with FIE would have given the new entity the second largest market share in the country next to BancoSol. However, despite approval by the Superintendent of Banks and Financial Entities, the merger did not materialize. The reasons for its failure are explored in Chapter 8.

Prodem Oportunidad, FFP remained, nevertheless, in a relatively strong position at the end of 2000. Its network of 52 branches was far larger than that of any other microfinance institution. It was the only financial institution to have branches in all nine regions of the country. BancoSol had the next largest network with 37 branches, but it was present in only 5 regions of the country and 84 percent of its branches were located in urban areas[12].

[11] Asofin, Cipame, and Finrural, Microfinanzas: Boletín Financiero (La Paz), no. 7 (December 2000), 59-61, and Superintendencia de Bancos y Entidades Financieras, "Evaluación del sistema Bancario a Junio 2000," Website: www.superbancos-bo.org.

[12] Asofin, Cipame, and Finrural, Microfinanzas (December 2000), 12-13.

Figure 5: Market Share by Size of Active Portfolio, Dec 2000

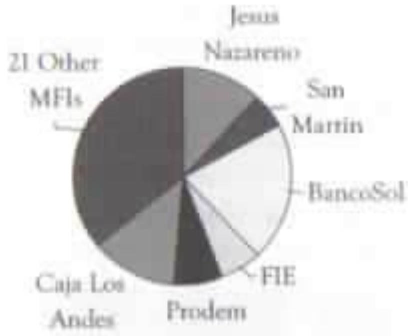
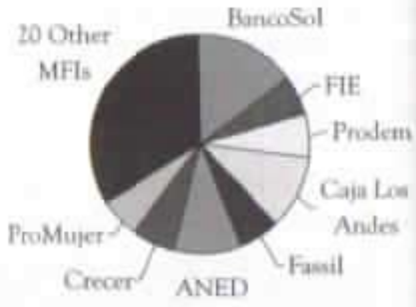
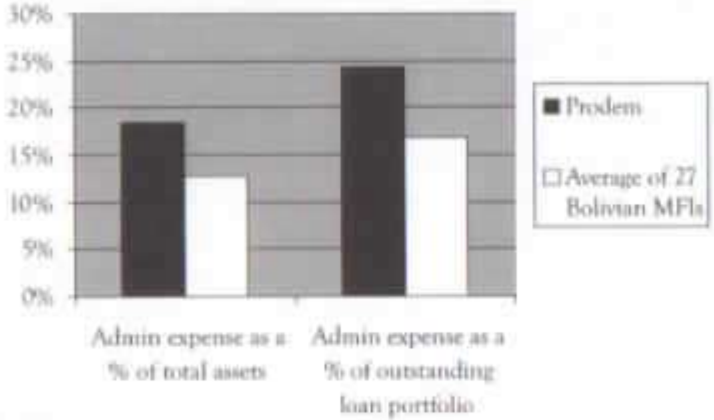


Figure 6: Market Share by Number of Clients, Dec 2000



It was significant that Prodem managed to keep all of its branches open, and even launch one new branch in 2000, despite the difficult external environment. Prodem paid a price for maintaining that network, as the relatively low efficiency indicators in Figure 7 demonstrate, but its network now provides the FFP with a competitive advantage in financial intermediation at the national level. More than any other Bolivian financial institution, it has the capacity to serve as a point of integration between urban and rural areas, the formal and informal sector, and the point of production and the point of sale.

Figure 7: Efficiency Comparison, Dec 2000



Source: Asofin, Cipame, and Finrural, Microfinanzas: Boletin Financiero (La Paz), no. 7 December 2000)

Figure 8: Prodem's Branch Network, December 2000

Prodem Oportunidad, FFP introduced several new products in the year 2000 including domestic wire transfers, international wire transfers, fixed term deposits, and savings accounts. It also introduced an innovative new technology for Bolivia – smart cards with digital fingerprint access. The cards operate with a microchip, not with the magnetic band that is characteristic of debit and credit cards, so they have the capacity to store data about a client's accounts and recent transaction history. In 2001, Prodem is introducing a mortgage product, an insurance product, and automated teller machines that speak indigenous languages. It is launching two new businesses, a software development company and an international consulting company. Soon, these two companies and the FFP will be managed by a holding company, which is part of Prodem's larger strategy of diversifying the risk inherent in the financial sector. Obviously, Prodem Oportunidad, FFP is not letting the stagnant economy dampen its ambition or its innovation.

The Prodem Foundation Reinvents Itself Again

As Prodem Oportunidad, FFP opened its doors, the Prodem Foundation attempted to reinvent itself yet again. Not surprisingly, it chose to maintain its focus on entrepreneurial development, but this time it sought to make an impact through non-credit initiatives.

This process of reinvention is a cycle the Foundation has been through before. Drawing lessons from past experience, it planned its transition well in advance of the FFP's actual launch. It identified staff members who would remain with the Foundation after the FFP's creation and these individuals began working on a new operational strategy more than a year before the transition took place. The Foundation even managed to recruit one of Prodem's original team members, Maria Elena Querejazu, to run the institution in its new phase. Querejazu moved from Prodem to BancoSol in 1992 as part of Prodem's first transformation and experienced a unique homecoming when she returned to Prodem eight years later.

The Foundation took its first major step toward a new mission in early 1999 when it commissioned a study of the market for non-credit services among Bolivian microentrepreneurs. As part of the study, a sophisticated computer database was developed to map Bolivian economic, demographic, environmental, human development, and basic infrastructure statistics at the national, state, and local levels, something that had never been done before in Bolivia. The database enabled Prodem to view the human, economic and natural resources of each of the country's 112 provinces. This information helped it understand why certain areas of the country developed while others did not, and to begin designing interventions that could improve access to resources that were lacking in a given area.

With this information, and with data collected on the supply and demand for non-credit services among microentrepreneurs, Prodem identified two strategies for improving rural entrepreneurs' competitiveness and their access to increasingly global markets. The first strategy aims to create model enterprises that will show potential investors that working with microentrepreneurs can be an attractive business opportunity. In 2000, Prodem launched two pilots in this area: Llamactiva, which is a company that commercializes products made from llamas; and Aguactiva, a company that supplies water services for agricultural production. Prodem is also negotiating a business agreement with a major marketer and distributor of organic food products in Bolivia.

The idea behind all three of these initiatives is to create private companies, managed by professionals, that will open links to national and

international markets for microentrepreneurs in a particular industry.[11] By generating local demand for a quality product, the businesses aim to motivate microentrepreneurs to make investments in improving the quality of their goods and services, thus making them more competitive in the longer term.

Prodem refers to this first strategy as "macrocapitalization." Its second strategy, by contrast, is known as "microcapitalization" and is essentially a joint venture. Prodem will identify successful rural microentrepreneurs with a solid business plan, and it will make an equity investment in their business. This strategy has been more difficult to put into action due to the lack of appropriate legal instruments and Prodem, once again, has had to be creative about the way it adapts to existing legislation. Nevertheless, in April 2001, it entered into its first agreement, which involved an equity investment of $1,500 in the business of a woman who raises llamas.

The microcapitalization and macrocapitalization strategies are connected, since it is microentrepreneurs who will supply the goods and services to be marketed by the larger companies. Prodem anticipates being able to support groups of microentrepreneurs that want to form new businesses to specialize in a particular component of the production process, for example, the cutting of llama fiber. It also plans to provide marketing services through which microentrepreneurs can access information about their customers, earn certification for organic farming, etc.

Prodem's ultimate goal, using a favorite slogan of people associated with the Foundation, is to launch initiatives that generate virtuous, rather than vicious, cycles of development by making microentrepreneurs active participants in their own advancement. That was the goal in 1987 when Prodem began developing credit services and it continues to be the goal today as it shifts to providing non-credit services. Using the lessons learned and capacity built during its first fourteen years, Prodem intends to continue pursuing mutually beneficial, sustainable relationships with microentrepreneurs, and through those relationships, make its contribution to Bolivian development. With an equity base of nearly $15 million, which can be used to leverage additional funds for its new development initiatives, there will certainly be more to Prodem's story in the future.

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PART II
Creating a Framework

Figure 9: The Components of Organizational Architecture[14]

Having chronicled Prodem's story and summarized its achievements, it is now possible to explore how Prodem built the capacity to envision and implement such achievements. Part II begins with a look at some of the ways in which Prodem's institutional design facilitated the capacity building process.

In his 1997 study on managing growth, Craig Churchill introduced the concept of organizational architecture as a tool for understanding the design framework of microfinance institutions. Drawing from business management literature, he identified institutional culture, human resource development and organizational structure as the three components that

[14] Craig Churchill, Managing Growth: The Organizational Architecture for Microfinance Institutions (Washington, DC: Development Alternatives, Inc., May 1997) 3.

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shape an institution's design. Culture provides the spirit and vision that guide an institution's activities and motivate its staff. Structure provides the order and channels through which employees apply their skills and experiences in an effort to make the institution function. Human resource development determines the extent to which staff can move the institution in the direction of its vision.[15]

The concept of organizational architecture is a useful tool because it approaches design holistically, emphasizing the interconnectedness of culture, human resources and structure in defining what an institution will look like and how it will function. In Prodem's case, it was clearly the integration of these three elements that created a strong framework for the institution's activities and a solid foundation for its growth.

The following three chapters explore how Prodem defined these elements and wove them together to create an original design that encouraged both innovation and efficiency. It also considers some of the challenges Prodem faced as it adapted this design to facilitate growth.

[15] For a more in-depth discussion of the concept of organizational architecture, see Churchill, Managing Growth. Churchill borrowed the metaphor of organizational architecture from two sources: Nadler et al., Organizational Architecture: Designs for Changing Organizations (San Francisco: Jossey-Bass Publishers, 1992); and Robert M. Tomasko, Rethinking the Corporation: The Architecture of Change (New York: American Management Association, 1993).

CHAPTER 2
Institutional Culture

Every organization has a unique culture. It has its own philosophy and principles, its own way of approaching problems and making decisions, its own work climate, habits and attitudes.* Interestingly, however, few organizations make a purposeful and systematic effort to define what their culture is. Most allow it to be determined informally by the personalities of key individuals or by the tone set in occasional corporate meetings and newsletters.

Prodem distinguished itself early in its history by placing particular emphasis on the definition and development of its culture. This resulted in an extremely strong identity and focus for the institution, and it enhanced Prodem's ability to attract and retain qualified staff, motivate their performance, and promote constant improvement in the quality of the institution's services. Significantly, Prodem's culture remained strong over time. More than a decade after its founding, employees were still referring to their institution's culture as "its heartbeat" and "the grease that keeps its wheels turning." This chapter looks at how Prodem managed to create such a strong culture. It also explores some of the challenges Prodem faced, and continues to face, as it tries to sustain its culture in a changing environment.

> *"Culture is Prodem's principal strength."*
>
> *– Jorge Arias, Regional Manager*

Demystifying the "Mística"

For years, visitors admired the way Prodem's culture supported and motivated its activities, and they struggled to put their finger on exactly

* Arthur A. Thompson and A. J. Strickland, Strategic Management: Concepts and Cases (New York: McGraw-Hill, 2001) 410.

how the culture worked. They frequ
"mística," a term used by many Prod
because they thought it captured that sp
the English language seemed to have no
mística" means "the mystical," and it
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This made it easy for observers to con
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Prodem's cultural model may or may
that gave it shape, and the processes th
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how to copy what Prodem did, but o
developing a powerful corporate culture

Conceptual Origins

The seeds of Prodem's culture were sown
long before the institution came into
existence. They were planted by a
handful of development theorists into
the minds of social activists who tossed
them around, pulled them apart, and put
them back together again in an effort to
figure out how to make grassroots
development happen. Pancho Otero wa
During a dynamic period of Bolivian
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later, his ideas would also have a major
Otero credits Freire with having inspired
tenet: the belief that "people are worth w
own." According to Otero, this idea

how the culture worked. They frequently adopted the Spanish word "mistica," a term used by many Prodem staff, to describe the culture because they thought it captured that special, intangible element for which the English language seemed to have no word. Translated into English, "la mistica" means "the mystical," and it described fairly well the almost magical feeling that visitors experienced when they got caught up in Prodem's dynamic, committed, and collaborative environment.

Unfortunately, the term also gave the impression that the cultural framework built by Prodem was somehow mysterious and unexplainable. This made it easy for observers to conclude that it simply could not be understood. Even though they recognized its importance, they dismissed its relevance as a model for other microfinance institutions because they believed its success and influence were dependent on some unique chemistry that could not be replicated.

Prodem's cultural model may or may not be replicable, but the elements that gave it shape, and the processes through which those elements were developed, can be identified. Examining them sheds some light, not on how to copy what Prodem did, but on how to support the process of developing a powerful corporate culture in other microfinance institutions.

Conceptual Origins

"Nothing in life comes from scratch."

– Pancho Otero, former Executive Director, Prodem

The seeds of Prodem's culture were sown long before the institution came into existence. They were planted by a handful of development theorists into the minds of social activists who tossed them around, pulled them apart, and put them back together again in an effort to figure out how to make grassroots development happen. Pancho Otero was one of those activists.

During a dynamic period of Bolivian history preceding the dictatorships of the 1970s, Otero was introduced to the ideas of various development theorists as a teenager. One of these theorists, Paolo Freire, made a particularly strong impression on him, and on many of Prodem's first employees. Freire's seminal work, Pedagogy of the Oppressed, was already influencing development practitioners around the world, but two decades later, his ideas would also have a major impact on Prodem.

Otero credits Freire with having inspired Prodem's most important cultural tenet: the belief that "people are worth what they can do and not what they own." According to Otero, this idea "flies bang, right in the face of traditional finance, and is the basis for a well-applied solidarity guarantee scheme." It values the human potential of microentrepreneurs and the economic potential of their businesses rather than the financial value of the physical assets they can offer as collateral. The idea was the cornerstone of Prodem's operational philosophy.

Freire made his second contribution by focusing Otero and his team on the micro level. Paraphrasing Freire, Otero comments, "Development is what happens when the smallest, most marginal, most humble guy off the street prospers, and not when roads and hydroelectric plants and big buildings are constructed." While Otero recognizes the importance of infrastructure projects in creating the preconditions for development, he insists that such projects are not in themselves development. Development happens at the level of the individual and within that individual's family. This focus is reflected in Prodem's mission statement and its institutional commitment to "work for the development of marginalized Bolivian families."

"From Freire came our most important idea: people are worth what they can do and not what they own."

– Pancho Otero

Freire's third contribution was his faith in participatory processes. In building Prodem, Otero and his team were guided by Freire's belief that "development is when the ideas of all are taken into account."[11] They designed Prodem's organizational structure and its communication channels so that all employees would have the opportunity and means to participate in the institution's decision making. They made it an institutional priority to listen to clients and found ways of incorporating client feedback into the product development process.

"Development is when everybody has a chance to make their economic idea a reality."

– Pancho Otero

Interpreting "ideas" to mean "the economic ideas or projects" of each individual, Otero and his colleagues restated Freire to define Prodem's own philosophical mantra: "Development is when everybody has a chance to make their economic idea a reality." They set out to build an institution that would support that kind of development and were encouraged in their effort by another important theorist, Abraham Maslow. Through Maslow's hierarchy of needs, Prodem staff came to view

[11] Otero paraphrasing Freire in an interview held on April 27, 2000.

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Consolidating a Culture

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Gross confirmed the validity of these
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development as a step-by-step process that could be facilitated by microenterprise promotion. If Prodem provided access to small, sequential, working capital loans, it could support microentrepreneurs in making their economic ideas a reality. That would be the institution's raison d'être and the strategy with which it would contribute to Bolivia's development.

Consolidating a Culture

All of these ideas were part of Otero's psyche before he began the Prodem project. They were also in the minds of many of Prodem's early employees since Otero purposefully recruited individuals who held these beliefs, a practice discussed in more detail in Chapter 3. Otero's decision to recruit likeminded employees, rather than to recruit people who met a specific technical profile, was the first step in consolidating Prodem's culture.

The second critical step involved the assistance of Steve Gross of Acción. Gross had developed a course on management and communication skills using information and experiences he had gathered during his time at Acción and as a former Jesuit priest in Honduras. In the fall of 1987, he gave this course to Otero and approximately 20 Prodem employees in the small town of Coroico, about four hours drive from Bolivia's capital city of La Paz. According to Steve, the ideas he presented "hit Pancho over the head like a 2 x 4." He understood them implicitly and knew then and there that they were what would make Prodem Prodem. Otero recounts the event in a similar manner, saying that "Steve's stuff fit us like a glove and we understood it like that (clicking his fingers)."

The materials Gross presented at the Coroico training made a powerful impression on Otero because they reflected ideas with which he and his team were already familiar. Since Gross had also been influenced by Freire and Maslow, his materials contained ideas that Prodem could relate to and make sense of – ideas it already believed in. Gross confirmed the validity of these ideas, but even more importantly, he presented techniques and strategies for turning the theoretical ideas into management practice.

> *"Steve Gross brought Freire's complex ideas down to management techniques."*
>
> – *Pancho Otero*

Before Otero met Gross, he knew that he wanted to create a culture within Prodem that was radically different from that of previous microcredit experiments in Bolivia, and completely opposite that of a typical commercial bank. He wanted Prodem to treat poor people with respect and deal with them as partners in development, not as beneficiaries of someone else's generosity or a risk to be avoided. He also wanted to create an institution in which employees considered themselves part owners and genuinely cared about their work. Otero believed he could create this kind of institution by building a culture that was based on trust and service, rather than on collateral or handouts.

Gross empathized with Otero's vision and, with input from Prodem, designed a series of management and communication seminars that helped make that vision a reality. The seminars introduced Prodem staff to a set of four principles for accomplishing their institutional goals. Together, these four principles focused Prodem on creating a culture of excellence.

Table 6: Four Principles of Excellence

1. *The task is of such magnitude that only an excellent organization can adequately respond.*
2. *An excellent organization is composed exclusively of excellent personnel.*
3. *People can aspire to excellence to the extent that they feel that they are on the road to satisfying their personal and professional needs.*
4. *The responsibility for creating, maintaining and strengthening such a productive working environment must be borne by each and every person in the organization.*

Source: Acción International

In 1987, excellence was not a part of Otero's vocabulary, although the principles Gross presented made complete sense to him. The concept of excellence brought together many of the ideas he was already committed to and provided a mechanism for applying them. By practicing excellence, Prodem could simultaneously strive to provide a valuable service and build self-esteem in both its clients and staff. In Otero's words, "the pride that comes from a job well done tied in very well with our need to be proud and our need to instill pride in poor clients to whom society had been saying for so long, 'you are a basket case.'"

The management seminars explored these four principles as well as the concepts that lay behind them, such as self-actualization, responsibility and commitment. They strengthened employees' interpersonal skills, and improved their ability to work as a team. The seminars also played an important role in motivating staff to value Prodem's culture. By explaining the interdependent impact that methodology and motivation have on an institution's health, the seminars encouraged employees to place as much emphasis on creating an empowering work environment as they did on

making loans. It was thought that by
they do, but how and why they do
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Figure 10).

Figure 10 : The Two Pillars

METHODOLOGY
What we do
Hard technology
Results
Financial
Methodology

Source: Acción International

The final and perhaps most importa
of Prodem's culture were the examples s
Prodem staff members. Otero not o
described above, he practiced them.
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"If you have the leader of an institution buying in totally, living [the culture], everyone else will see that it can work for them too."

– Steve Gross, Acción International

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making loans. It was thought that by paying attention not only to what they do, but how and why they do it, staff could create the kind of institutional strength that would enable Prodem to achieve its goals (see Figure 10).

Figure 10 : The Two Pillars of Institutional Strength

METHODOLOGY		MOTIVATION
What we do	⟷	Why we do what we do
Hard technology	⟷	Soft technology
Results	⟷	Work environment
Financial	⟷	Non-financial
Methodology	⟷	Ideology

Source: *Acción International*

The final and perhaps most important factor in the early consolidation of Prodem's culture were the examples set, first by Otero and later by other Prodem staff members. Otero not only valued the cultural principles described above, he practiced them. He gathered his staff together, put issues on the table, and allowed decisions to be made by consensus. He put a great deal of effort into establishing relationships of trust and respect with his staff. In his dynamic and determined way, he pushed staff to find creative ways of solving problems and to cooperate in the implementation of solutions. Thus, before employees had any formal training or exposure to the four principles, they were absorbing Prodem's culture through the institution's leader. His enthusiasm was contagious.

> *"If you have the leader of an institution buying in totally, living [the culture], everyone else will see that it can work for them too."*
>
> – *Steve Gross, Acción International*

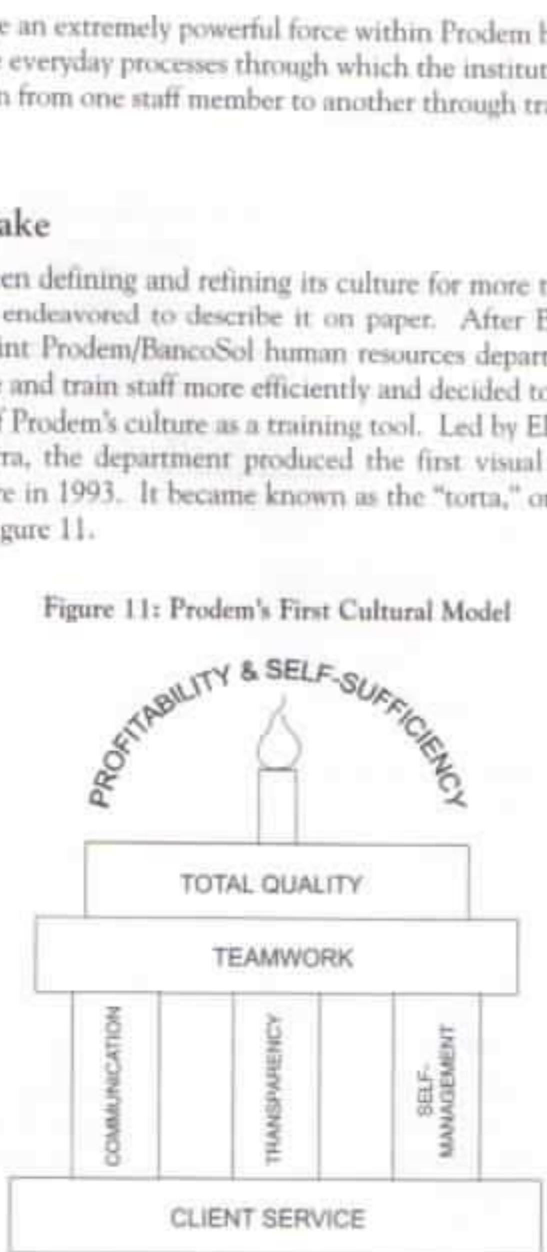
When Gross came into the picture, he helped everyone systematically internalize the core set of beliefs that would become Prodem's culture. As Gross explained, "The idea was to start with concepts and then move to attitudes. It wasn't enough to understand what teamwork and communication were; you had to make it an attitude. Then, the attitudes had to become habits, not only personal habits but institutional habits. Once institutional habits are built up, it's easier for new employees to go along with them than to fight them."

Culture became an extremely powerful force within Prodem because it was woven into the everyday processes through which the institution operated. It was passed on from one staff member to another through training and by example.

Baking a Cake

Prodem had been defining and refining its culture for more than six years before anyone endeavored to describe it on paper. After BancoSol was created, the joint Prodem/BancoSol human resources department looked for ways to hire and train staff more efficiently and decided to diagram the key elements of Prodem's culture as a training tool. Led by Eliana Otondo and Jose Becerra, the department produced the first visual rendition of Prodem's culture in 1993. It became known as the "torta," or cake, and is illustrated in Figure 11.

Figure 11: Prodem's First Cultural Model



In the cake, one can identify all the major elements of the institution's culture. The first layer represented the dedication to service. Everything the organization did depended upon its ability to serve three types of

ients: a) the external client (the borrowe olleagues), and c) the personal client (on

Upon the foundation of service, three pillar of *communication* represented the im giving and receiving feedback, questioning a way that treated others with respec symbolized the attitude of openness and ho pursued its tasks in order to build trust a The pillar of *self-management* characterize ability of staff members to complete their ability, using their own initiative, skill represented by these three pillars remained history even though the way they were ex Box 1 for an example).

The three pillars supported the secon They made it possible for members of th towards a common objective, not by co rather, by each person doing his or her pa desired direction. Prodem believed th institution's ability to operate efficiently, establish strong relationships among its m

The third layer of the cake, *total quali* created by the elements described above. commitment to excellence and to a contin the quality of its operations. Finally, th represented *self-sufficiency*. It celebrated th results over the long term by operating effic income to cover its costs.

Cultural Revision

As Prodem and BancoSol matured as i matured. Concepts were reinterpreted, s more than they had been before and oth Prodem continued to describe its culture u When Prodem created its own human res led a detailed re-evaluation of Prodem's c redefining the institution's identity. As a was created, this time in the form of a hou accurately reflect the culture that Prodem

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clients: a) the external client (the borrowers), b) the internal client (one's colleagues), and c) the personal client (oneself).

Upon the foundation of service, three pillars were constructed. The pillar of *communication* represented the importance of sharing information, giving and receiving feedback, questioning and listening, and doing this in a way that treated others with respect. The pillar of *transparency* symbolized the attitude of openness and honesty with which the institution pursued its tasks in order to build trust and be accountable to its clients. The pillar of *self-management* characterized the institution's belief in the ability of staff members to complete their own tasks to the best of their ability, using their own initiative, skills and creativity. The values represented by these three pillars remained important throughout Prodem's history even though the way they were expressed changed over time (see Box 1 for an example).

The three pillars supported the second layer of the cake, teamwork. They made it possible for members of the institution to work together towards a common objective, not by completing all tasks together, but rather, by each person doing his or her part to move the institution in the desired direction. Prodem believed that teamwork was key to the institution's ability to operate efficiently, generate creative solutions, and establish strong relationships among its many stakeholders.

The third layer of the cake, *total quality*, rested upon the foundation created by the elements described above. It represented the institution's commitment to excellence and to a continuous process of improvement in the quality of its operations. Finally, the candle on top of the cake represented *self-sufficiency*. It celebrated the institution's ability to achieve results over the long term by operating efficiently and generating sufficient income to cover its costs.

Cultural Revision

As Prodem and BancoSol matured as institutions, their cultures also matured. Concepts were reinterpreted, some elements were emphasized more than they had been before and others less. Despite the changes, Prodem continued to describe its culture using the cake model until 1995. When Prodem created its own human resources department, Jose Becerra led a detailed re-evaluation of Prodem's culture as part of the process of redefining the institution's identity. As a result, a new conceptual model was created, this time in the form of a house, which was thought to more accurately reflect the culture that Prodem had developed.

Box 1: Revising the Concept of Self-Management

One of the most interesting developments in Prodem's institutional culture was the evolution of the concept of self-management. As shown in Figure 11, self-management was one of the three core pillars in Prodem's early cultural framework. It was an important value that was grounded in the high degree of trust that the institution placed in its employees. Prodem's leadership believed in the ability of employees to work together to achieve the institution's objectives and encouraged them to take the initiative to solve problems. Staff members were asked to work as a team in deciding the best way forward and to distribute responsibilities accordingly. There were no time clocks and no rigid job descriptions. Staff felt empowered to accomplish just about anything and everything.

As Prodem grew, however, the concept of self-management was called into question. This happened for two main reasons. First, the concept began to be misinterpreted by individuals who viewed it as a license to approach their work in ways that suited their personal needs. Losing track of the fact that self-management was executed in a context of team responsibility, these staff members began to keep their own hours, break institutional policies, and make decisions without consulting their colleagues.

Second, as Prodem grew, it was not possible for a field worker in a rural branch in the south to know what was best for a semi-urban agency in the west. The sheer volume of employees and the distance between them made communication difficult. Teams had to be broken down into smaller groups and processes had to be established to determine what were the best interests of the institution. These processes resulted in policies that were distributed to all teams to guide their decision-making. Understandably, it was difficult for staff to accept the coexistence of self-management as a guiding principle with an increasing number of rules and regulations that placed limitations on their ability to manage themselves.

Because of these two trends, Prodem's new framework replaced self-management with the pillar of values and introduced the concept of personal integrity. The message shifted. Prodem tried to convey that the values behind self-management remained an important part of the institution's identity, but the concept needed to mature just as Prodem was maturing. Self-management was not sustainable given the level of growth, and the changing shape and needs of the institution. What was sustainable, and what was most important, Prodem argued, were the concepts of trust, responsibility and personal integrity. Prodem would trust its staff to manage their own tasks, but it would also hold them responsible for doing so in a way that fulfilled the best interests of the institution.

Prodem's new message was fairly well received by its staff, but not without a sigh. The shift in conceptual frameworks built institutional capacity for growth, but it also altered the relationship between Prodem and its staff. Many viewed the increasing controls and changing rules as a sign of decreasing trust by the institution in its staff, and led employees to put some distance between themselves and Prodem. This trend from a personal to a more professional relationship between organization and its staff is discussed later in this document as one of the more complex factors contributing to Prodem's overall strength.

Figure 12 : Prodem's In

The house model contained most of t
well as several new ones. A comparison
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Service

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Figure 12 : Prodem's Institutional Culture 1998

The house model contained most of the elements of the cake model, as well as several new ones. A comparison of the two models is worthwhile to explore some of the changes Prodem made in response to lessons learned. In general, the revision was not a radical renovation or demolition of what came before. The elements that Prodem considered important in 1987 remain important today, but in most cases those elements are better understood, and their relationships with each other are more richly conceived. This improved understanding strengthened Prodem's culture and enhanced its ability to manage growth.

Service

In re-examining its culture, Prodem realized that its foundation was not the services it rendered, but rather, the members of its staff who provided those services. Institutional excellence depended on personal excellence. Thus, Prodem made personal integrity the cornerstone of its culture in an effort to encourage employees to strive for excellence as human beings and not just as employees. It wanted its employees to be conscious of their thoughts, feelings and actions and to seek coherence among them. It believed that people who sought such coherence would constantly be improving themselves, and therefore, constantly be improving their work performance.

Prodem also believed that when individuals with personal integrity pursued their daily tasks with the values, transparency and team spirit espoused by Prodem, they would enable the institution to provide a total quality service to both its internal and external clients. Prodem's decision to combine what used to be two separate cultural elements—total quality and customer service—illustrates how the institution's approach matured. Service and quality are now seen as integrally linked processes. One cannot be provided without the other.

Values

Prodem recognized that one of its strengths is the "moral authority" provided by its culture. Situated in a country that has consistently ranked among the top twenty percent of the world's most corrupt countries in studies by Transparency International, it is no small accomplishment to have established a financial institution that prides itself on its accountability, transparency, and honesty.[18] This image attracts employees to the institution because they see Prodem as a place where things are done differently, a place where values exist.

Unlike many commercial enterprises that shy away from defining a value-based statement of their activities, Prodem emphasizes that its work is possible precisely because of its values and stresses from the beginning that all employees must uphold those values. Staff are expected to be honest in their relationships and in their treatment of the institution's resources. Any act of dishonesty or fraud, no matter how small, is cause for dismissal. Employees must commit themselves to the work of the institution and to the long-term pursuit of its mission. They must respect each other and the clients they serve, regardless of any difference in opinion, culture, social or economic status.

This value-based strategy is demanding, but it appeals to staff because it is a two-way street. The institution expects a great deal from its employees, but in return, employees can expect a great deal from Prodem. They can

[18] In 1998, Bolivia ranked 69 out of 85 countries listed in the Corruption Perceptions Index compiled jointly by Transparency International and Göttingen University. In 1999, it ranked 88 out of 99, and in 2000, it ranked 71 out of 90. Additional data can be found on the Transparency International web site, www.transparency.org.

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of its strengths is the "moral authority"
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, www.transparency.org.

expect to be trusted, to be given responsibility, to be dealt with honestly, to be invested in, and to be respected. Prodem's employees claim that when they joined the institution they not only signed a legal contract; they also entered into an informal social contract that often carries more weight than the legal contract itself.

Communication and Teamwork

Communication and teamwork were the two elements of Prodem's cultural framework that changed least over time. Paradoxically, they were also the two most difficult elements to maintain as the institution grew.

The larger Prodem became, both in terms of the number of personnel and the number of miles across which they were scattered, the more difficult it became for staff to communicate with each other and to cooperate with each other in the resolution of problems and the making of decisions. It was expensive and time consuming to bring all of Prodem's staff together. It was physically impossible for national managers to visit each branch even once a month.

In response to growth, and to prepare for additional growth, Prodem invested heavily in mechanisms to facilitate communication and collaboration on a larger scale. It reorganized its structure to create smaller work teams and it enhanced its computerized information system, processes that are discussed in more detail in Chapters 5 and 6. It also placed heavy emphasis on the values of transparency, participation, teamwork and communication.

> *"He who does not work in a team does not work in Prodem"*
>
> – *Staff Slogan*

Senior management insisted that the institution would never achieve its mission if its staff did not work together in pursuit of that mission. It was unnecessary, they argued, for everyone in the institution to sit around the same table solving the same problems, but it was vital for everyone to work towards a common set of objectives and to feel they were an important part of the Prodem team. They challenged staff to find creative ways of making this happen within the new environment. Some of the responses by staff can be found in subsequent chapters.

Paradigms

The final pillar holding up Prodem's cultural house represents a commitment to challenging the status quo. It questions assumptions and it actively searches for new ways of solving problems, of interacting with the environment, and of serving clients' needs. Understanding that the secret to survival for any business lies in its ability to adapt and innovate, Prodem made it an early priority to become a learning organization and challenged its staff to use their experiences to constantly improve their own and the institution's performance.

Although Prodem had long taken pride in breaking paradigms, it did not include this element in the first visual rendition of its institutional culture. Its inclusion in the second model was largely the result of lessons learned when creating BancoSol. Growth and transformation necessarily required changes in the way the institution conducted its business, but since the institutional culture of the early 1990s did not include an expectation of change, introducing new values or ways of doing things proved difficult. Staff members were suspicious, and sometimes even fearful. By including change as a positive and central component of its culture, Prodem helped prepare its staff for the unexpected and encouraged them to be open-minded about new concepts and decisions. This change in culture was at least partly responsible for the smoother transition experienced by Prodem in creating its FFP.

Mission and Vision

Comparing the candle on the cake and the roof of the house in the two renditions of Prodem's culture, one can see changes in how the institution conceptualized and conveyed its mission and vision. The latter scheme more richly describes what was always important to Prodem, the delivery of a quality service that enabled: 1) the institution to be sustainable; 2) the staff to find fulfillment in their work; and 3) microentrepreneurs to receive long-term access to the financial system. Being able to provide this access is what made it possible for Prodem to progress towards its ultimate vision—the development of Bolivian families.

As the guiding framework for the organization's work, it was important that Prodem's culture always stressed the interdependent relationship between these elements and sought a balance between them. Although Prodem's ultimate vision was social, it could not achieve that vision without empowering its staff and without being profitable. Prodem's mission, which in 1986 was simply stated as "supporting and enhancing the quality of life of Bolivian microentrepreneurs by offering non-subsidized credit,"[illegible] was refined and expanded over time to convey more explicitly the institution's multifaceted objective:

> Through self-motivated personnel and the constant search for total quality, Prodem commits itself to introducing financial services primarily in the rural areas and secondary

[illegible] Prodem, "Twelve Years Promoting and Developing the Microenterprise Sector" (La Paz, 1998) 8.

> cities of the country; thereby
> services through viable and
> working for the development
> commitment is long term.[illegible]

Prodem's vision—the sustainable de
placed everything the institution did, a
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For years, Prodem used the illustratio
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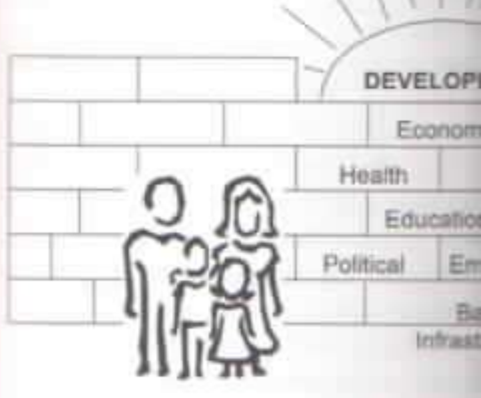
Figure 13 : Developm



[illegible] Prodem, "Twelve Years," 2.
[illegible] Prodem, "Twelve Years," 23.

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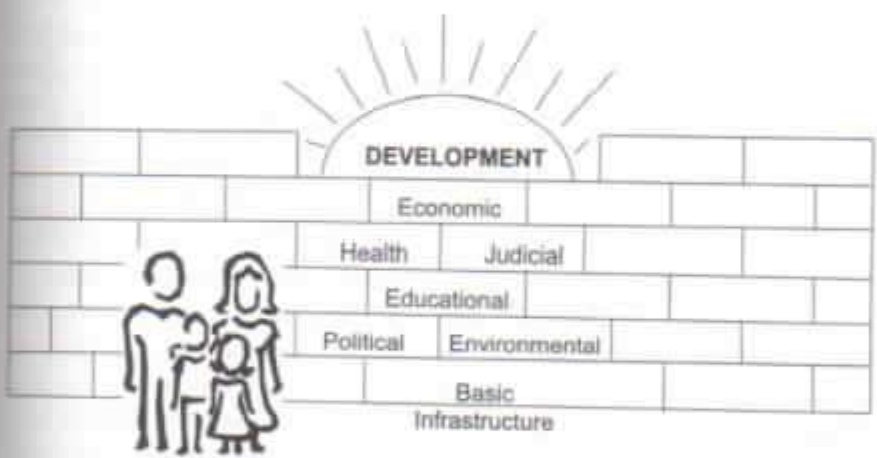
Developing the Microenterprise Sector" (La Paz,

> cities of the country; thereby massifying access to these services through viable and permanent operations; working for the development of Bolivian families. Our commitment is long term."

Prodem's vision—the sustainable development of Bolivian families—placed everything the institution did, and everything it aimed to be, in a social context. It was a grand vision, particularly in a country ranked second poorest in the hemisphere, where the majority of the population lacked access to health and education services, to the judicial system, to basic infrastructure, and to economic resources. From Prodem's perspective, each of these deficiencies constituted a barrier to a family's development, and therefore, to the development of Bolivian society. As an institution, it chose to address one of the barriers, the lack of access to economic resources, but it did so with a consciousness of the larger development context and did not treat credit as the unique solution to Bolivia's development problems.

For years, Prodem used the illustration provided in Figure 13 to explain its vision and mission within this broader context. It emphasized that there was an entire wall of barriers, represented by bricks in the diagram, which kept marginalized families from developing. By providing access to financial services, Prodem aimed to chip away at a few of the bricks in that wall, but there were hundreds more bricks, and knocking them down would require the cooperation of a whole range of different actors and efforts.

Figure 13 : Development Barriers



Prodem, "Twelve Years," 2.
Prodem, "Twelve Years," 23.

Prodem's recognition of the complexity of development assisted it in achieving its objectives. It enabled the institution to build relationships with clients that were not based solely on economics, and motivated Prodem to experiment with new ideas and products for serving its clients' varied needs. Once it had succeeded in massifying access to financial services through BancoSol and Prodem Oportunidad, FFP, the Prodem Foundation was able to refocus itself with relative ease on other ways of supporting its clients' development. In 2001, the Foundation redefined its mission, but its vision remained constant:

Mission: *To promote the modernization of the small entrepreneur and microenterprise, particular in rural areas, assuring a quantitative and qualitative improvement in its institutionalization process, its competitiveness and access to more dynamic markets,...*

Vision: *...so that as a whole, it can contribute significantly to the sustainable development of the country.*

Built to Last?

Prodem's culture remained very strong throughout the 1990s. In many respects, it was the glue that held the institution together. It provided the vision that employees rallied behind and the ideas that inspired their hard work and dedication. It provided standards of excellence that guided, and often compelled, the institution's work toward the fulfillment of its mission. It encouraged employees to be innovative in meeting those standards, to constantly seek ways of doing things better, and to not be afraid to learn from their mistakes. For years, Prodem's culture provided such a strong center of gravity that new employees were simply sucked into the institution's way of doing things. Even if they did not fit exactly into the Prodem mold, it was easier for them to adopt the institution's habits than to reject them.

By creating a culture based on trust and excellence, and by making the continued strength of that culture an institutional priority, Prodem created an environment that encouraged people to be the best they could be,

"One cannot see the corporate culture. It is not a budget line item, and it does not have a monetary value. But it does have an economic value. In successful institutions, culture represents one of the most important assets of the organization."

– *Craig Churchill, in "Managing Growth"* and not just do the best they could do. It created an environment in which people felt empowered. Empowered employees ended up building an institution that knew how to dream and had the audacity to implement those dreams. This was a competitive advantage for Prodem, and it helps to explain why so many visitors left the institution feeling as if they had been exposed to a little bit of magic.

By the end of the decade, however, Prodem's external environment began to change quite dramatically, and this had a major impact on the institution's culture. As external competition intensified, overindebtedness grew, and the economy weakened, Prodem found itself fighting fires on a number of fronts. It was responding to delinquency levels that had never before been experienced by the institution, it was installing new systems and preparing to launch new products as part of the FFP transformation, it was negotiating a merger with FIE, and it was struggling to combat the political backlash being generated by debtors groups.

> *"There was no room to breathe. There was always an emergency that got in the way of the non-technical side of human resource development."*
>
> – Sergio Prudencio, National Operations Manager

In facing these challenges, Prodem had to channel its limited resources to areas that required the most urgent attention. Since its culture was already strong, it directed few resources in that direction. In fact, resources that were routinely devoted to maintaining the culture were diverted into other areas. Beginning in mid-1999, all cultural training courses were postponed, as were the introductory orientation courses provided to new staff. The Department of Organizational Development focused its resources on developing and implementing technical training courses that would help loan officers improve their delinquency management and economic evaluation skills, provide branch managers with additional leadership training, and bring everyone in the institution up to speed on the new information system.

It should come as no surprise that Prodem's culture weakened as a result of this shift in priorities. Since new employees received no cultural training and those employees who had been with the institution for only one or two years did not receive any reinforcement of their initial training, subcultures emerged. New employees had no way of understanding Prodem's past, its traditions or its values, and this created schisms with old employees who based so much of their identity on their history with the institution. Turnover increased and the number of cases of corruption rose. One employee went so far as to say that "Prodem's spirit had disappeared."

Clearly, one of the most important lessons to be drawn from Prodem's recent experience is that culture must be constantly and deliberately nurtured if it is to remain strong. Yet to draw the conclusion that the weakening of Prodem's culture was simply due to the lack of attention it received during the last two years would be both naïve and misguided.

The external challenges of 1999 and 2000 put pressure on Prodem's culture in more direct ways, three of which are worth mentioning here. First, the harsh environment wore down the institution's cultural reserves. During this period, Prodem was able to marshal its resources in incredible ways to pull the institution through the peak of crisis. This was in large part due to the strength of its culture and its ability to motivate staff through deeply-held values. Having been pushed to their limits, however, employees needed to recharge. Yet with the external environment still looking grim, with clients in continued difficulty and the institution not growing, there were few sources of energy from which to recharge. Even staff in the Department of Organizational Development were burning out, and this made it extremely tough for Prodem to maintain its culture through normal operations.

Second, Prodem had fattened its organizational structure to support growth that never came, so that by mid-1999, layoffs became necessary. It was the first time in Prodem's history that employees were dismissed en masse and it naturally damaged the social contract with staff. Previously, staff members were assured that if they made a commitment to Prodem, Prodem would make a commitment to them. After the layoffs, employees became more insecure about their relationship with Prodem. They became more risk-averse and more afraid to make mistakes. In the short-term, this negatively affected the institution's culture because it made staff less trusting, less innovative and less willing to initiate change.

> *"Before I could mess up and get training; now I mess up and I get fired."*
>
> *– Prodem employee*

Third, Prodem needed a new business strategy to compete effectively in its changing environment and the launching of that strategy required some changes to the institution's culture in order to create a solid fit between it and the new strategy. For example, shareholders needed to be incorporated into the scheme and the social contract between Prodem and its staff needed to be redefined. Essentially, Prodem had to distinguish between the core and peripheral elements of its culture, being careful to retain the former and adapt the latter as necessary to recreate a culture that could provides competitive advantage in the new external and internal environment. Prodem Oportunidad, FFP has been engaged in that process

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for several months now, but the going has been tough. After all, how does an institution define and promote a new culture when its internal and external environment are still changing so much so fast? For the Prodem Foundation, the process has been much easier, since it has had far fewer challenges to respond to in the short term.

The culture in both institutions is necessarily evolving. Figuring out how to keep it strong in the midst of a constantly changing environment is a challenge they now share with mature institutions everywhere.

∽ Chapter 3 ∾
Human Resource Development

To build an institution with the culture described in Chapter 2, Prodem brought together a very special, high-caliber team of people. Again, it distinguished itself early on by recognizing the careful and constant effort this would take, and by designing a rigorous recruitment and training process. Prodem made human resource development the cornerstone of its institutional development. It put programs in place that enabled employees to build their capacity and motivated them to maximize the use of their skills in pursuit of the institution's growth. This chapter takes a look at Prodem's approach to human resource development and its ability to withstand the test of time.

Hiring the Right Staff

Prodem's first employees were hired directly by Pancho Otero and they were hired on the basis of their belief in the core ideas upon which Otero wanted to build Prodem. He recruited young people with high hopes and creative energy, who relished the opportunity to break paradigms and prove skeptics wrong. Most importantly, he hired people who he thought would be committed to the new institution.

"An institution is built by the people within it."

– Jose Becerra

Before coming to Prodem, Otero worked with a number of revolving loan funds. Each year, during the harvest and planting seasons, he had to find a few extra pairs of hands to help him with disbursements. Through trial and error he learned that the best recruits were landless men with a peasant background, who knew the region well, worked odd jobs and, as Otero puts it, "had made some kind of commitment to the Virgin Mary." He found that the only people he could really trust were those who were totally committed to some cause. Initially, it he thought it had to be a

religious cause, but later, he found that
did not matter whether someone
grassroots organizing or microenterprise
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When it came time for Otero
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"When we finally got some right person in a particular city (something that was immediately evident to us when it happened) we drilled them: 'where do you come from; what did your father do; who are your friends; where were you trained; who were your teachers?' Then we said, 'Are there more like you where you come from? Bring them all tomorrow.'"

– Pancho Otero

APTER 3

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religious cause, but later, he found that the cause could also be political. It did not matter whether someone was committed to development, grassroots organizing or microenterprise. What mattered was the presence of commitment, or the potential for commitment.

When it came time for Otero to hire Prodem's first employees, he looked for people with a commitment. He found it, one by one, in Mario Usnayo, Monica Velasco, Lidia Calle, Patricia Gallardo, Judith Fuentes, Edgar Medina, Luis Geng, German Sanchez, Carlos Villaroel, and Johnny Ugarte. These ten people formed Prodem's core. Together with Otero, they defined Prodem in its early years.

"Who else could you trust with saddle bags full of money in a mule train to walk some thirty miles through the jungle and not arrange a hijack, or for that matter to not put their hands in the till?"

– Pancho Otero

When Prodem began to expand to other regions of Bolivia, it sought new employees in those regions who fit the commitment-based profile. At first the process was hit or miss. Otero recalls one city in which it was a complete disaster. They had to fire all six people and start over again. But once they identified one person who fit the profile, the rest became easy. Through that person, they recruited other employees with similar backgrounds and soon established a core team for that region.

As Prodem grew, it needed to identify and hire the right kind of employees quickly and in large numbers. It did this through incubators—places that either attracted or cultivated people with attitudes and beliefs similar to those of Prodem. In El Alto, Prodem's incubator turned out to be the School of Social Communication at a fairly radical university; in Santa Cruz, a grassroots street theater company; in Cochabamba, a church group that did community organizing. Prodem's most surprising incubator was the Patrice Lumumba University in Russia. Otero still remembers the day he realized there were 14 people on his staff who had received scholarships and studied there.

"When we finally got some right person in a particular city (something that was immediately evident to us when it happened) we drilled them: 'where do you come from; what did your father do; who are your friends; where were you trained; who were your teachers?' Then we said, 'Are there more like you where you come from? Bring them all tomorrow.'"

– Pancho Otero

Once Prodem identified an incubator, it focused its recruiting efforts there. It also used the incubator as an important screening device. For example, Prodem found that although the incubators were quite distinct, all of them seemed to have one thing in common—the presence of a charismatic or lucid leader who had a powerful influence as a teacher or organizer. If Prodem identified with a given leader, and if an applicant mentioned that he or she had been strongly influenced by that leader, Prodem felt fairly safe in concluding that the applicant and Prodem would make a good match.

> *"Finance can be learned, but commitment, or the ability to become committed, one cannot buy or teach or improvise. It is a gift that one is born with."*
>
> – Pancho Otero

By 1990, Prodem had 80 employees and was growing at an impressive rate. Coordinating the recruitment, hiring, and training of so many people was becoming increasingly difficult, so Prodem hired a professional from outside the institution to manage its human resource development activities. It recruited Manuel Cuevas, a psychology professor from the Catholic University. Otero comments, "We were lucky to have found him. After just a few months, he and his five graduate assistants had everything down pat and they began to systematize all that we had been doing helter skelter for the first three years. After that, everything was cookie cutter."

Cuevas and his team defined a rigorous procedure that formalized Prodem's recruitment and hiring process. The first step in that procedure was the definition of a profile for each job vacancy that needed to be filled. The profile specified the kind of person that Prodem wanted to hire and the basic skills and abilities he or she should possess. The technical requirements of each profile varied depending on the nature of the position being filled, but the cultural requirements remained constant. Prodem consciously sought individuals who identified with its mission and objectives, who could empathize with its clients, who would work hard as part of a team, who had the potential for growth and, of course, who would make a commitment to the institution. By including social and not just technical requirements in its professional profiles, Prodem increased the likelihood that it would recruit new employees who possessed both the aptitude and the attitude necessary to be able excel in the Prodem environment.

Once a job profile was defined, Prodem began identifying candidates who met the profile. Advertisements were placed in the most important national newspapers announcing the open position. Thirty-five to fifty CVs were received for each position, of which seven or eight people were

invited to participate in the next step
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invited to participate in the next step of the recruitment process. They were brought together and two exams were administered. The first was a psycho-technical exam that tested candidates' abilities in the areas of spatial, mechanic and numeric reasoning, verbal logic, and comprehension. The second exam consisted of group simulations that tested candidates' ability to work in teams, interact with others, and exercise leadership. If relevant, a third exam was given to assess whether the candidate possessed the technical knowledge necessary to carry out the responsibilities of a particular position.

Results of the exams were tallied and finalists were chosen competitively on the basis of their average scores. Each exam was weighted equally, but a minimum score was required on each exam in order to pass; there was also a limit on the acceptable difference between the scores of the different exams. This helped to ensure that future employees were relatively balanced in all of the areas Prodem identified as important.

In the last step of the recruitment process, approximately three candidates per position were interviewed to assess their ability to do the job in question and their affinity with Prodem's culture. Since Prodem was more concerned with the potential of the person being interviewed than with his or her past accomplishments, many of the questions asked involved hypothetical situations. The interviews were generally conducted by a panel that included the supervisor for whom the new employee would be working and a representative of the Human Resources Department.

Besides facilitating the recruitment of qualified staff, Prodem's rigorous hiring process helped established a culture of merit and integrity within the institution. Because the process was so intense, and involved so many stages and people, there was no single individual to whom an employee needed to feel loyal once he or she was hired. Loyalty could be given to the institution that had sponsored the process and to all of the other individuals who had survived it. Knowing that everyone had passed through the same quality check made employees feel like they were part of a high-caliber team, and that motivated them to perform as a high-caliber team.

The mechanisms employed in the recruitment process, and the rigor with which they were applied, enabled Prodem to hire the kind of employees who would work well within the institution. Its success in this effort is demonstrated by the low staff turnover rates enjoyed by the institution until its housecleaning in 1999, and by the fact that its hiring procedure remains essentially unchanged to this day.

Training

Since Prodem wanted to create a fundamentally different kind of lending institution with employees who had little or no financial background, training had to be a priority. It quickly became the primary mechanism through which Prodem promoted and preserved its culture, staff gained new skills, and the institution pursued excellence.

Between November 1986 and August 1987, Prodem received six technical assistance visits from senior staff at Acción headquarters and from Acción affiliates in Costa Rica, Paraguay, Guatemala and Panama. Prodem staff also traveled to Honduras and Colombia for training courses and observed the Acción affiliates there.[41] Besides these exchanges, Prodem staff received intense hands-on training by spending a great deal of their time in the trenches. Although hired for management positions, Pancho Otero, Mario Usnayo and Monica Velasco filled the shoes of loan officers for the first three months of the institution's operations. They were the ones who identified Prodem's first clients, made the first loans, dealt with the first defaulters, and made the first mistakes. They learned through trial and error how to apply and adapt the solidarity group methodology to the local context and, in the process, they learned a great deal about their clients, their clients' businesses and the market for financial services. As a result, once Prodem began to hire full-time loan officers in May 1987, its managers had a solid understanding of every facet of the institution's operations.

Prodem's orientation and training package was shaped by these early experiences. Beginning in 1988, each new employee went through an orientation process that included technical training, cultural training and fieldwork training. The orientation began with a week-long session of classroom presentations and group activities that introduced new employees to Prodem's history, operations and motivations. Its various modules covered everything from "what does it mean to work in a team" to "how does the solidarity group methodology work" to "what was the vision of Prodem's founders." Ultimately, the orientation aimed to indoctrinate new employees into Prodem's culture, to explain why the institution did things they way it did, and to solicit a commitment to being a part of that endeavor.

After a week in the classroom, employees spent approximately one month receiving hands-on training in the office where they would work. When possible, this training was conducted on a rotating basis with

[41] Henry Jackelin, Robert Blayney, and John H. Magill, "Evaluation and Preliminary Project Design for the USAID/Bolivia Micro and Small Enterprise Development Program" (Washington, D.C.: Development Alternatives, Inc., September 1987) II-2.

"When we were trying to figure out how to improve our cashier services, Pancho had all the national level staff spend at least one day a month as a cashier.... By watching clients count their coins and attempt to flatten out their crumpled bills, we began to understand who our clients were and began to build a relationship with them."

– Eliana Orondo, former Human Resources Manager, Prodem/BancoSol

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different staff members serving as mentors at various times so the new employee could find a style that worked best for him or her, and also receive feedback from a variety of different perspectives.

Once they completed the orientation period, staff members attended a follow-up seminar each year for the next five years. The seminar for first year employees differed from the session for fifth year employees, but the topics addressed all dealt with aspects of the institution's culture. In addition, all employees were given at least one other training opportunity each year. Employees knew they had this opportunity and, together with their supervisors and the Department of Organizational Development, they decided what type of training they would pursue.

"At Prodem you have the opportunity to develop yourself."

– Jose Herrera, Regional Manager

When Prodem identified an institution-wide weakness or when there was a frequent request for a particular type of training, the Department of Organizational Development generally provided an in-house course, drawing on external expertise as necessary. For example, as a direct response to the rise in arrears in 1998, all loan officers were given classroom and hands-on training in economic evaluation. In 1999, branch managers requested and received a training course in leadership. When the requested training was unique to a particular position or person, Prodem usually arranged for employees to attend specialized courses elsewhere. In several cases, Prodem designed distance-learning modules to respond to the difficulties for rural staff to attend training courses in the city.

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In addition to formal training, Prodem always encouraged its staff to create informal training opportunities. Managers involved their staff in participatory decision-making processes, in part to ensure that everyone understood and committed themselves to the decisions being made, but also to create a forum within which staff could learn from each other. Branch managers discussed problems with clients in a main room rather than in a closed office so that loan officers could learn problem solving and conflict resolution skills. The Department of Organizational Development had a library of reference materials available to anyone who was interested in learning about a particular theme. It also published a bimonthly newsletter, El Informal, which disseminated helpful hints, lessons learned, and articles on relevant technical or thematic topics.

Organizing and facilitating these training opportunities was expensive, but like the investment made in building the institution's culture, it was strategic. By investing in human resource development, Prodem institutionalized a capacity building process that was essential for future growth. It cultivated employees with a common cultural foundation and a core set of skills, and it improved those skills over time, which helped the institution prepare for anticipated opportunities and challenges. When unexpected changes took place, Prodem's well-lubricated capacity building machine helped the institution quickly design and implement training that enabled its staff to respond to the changes. The fact that Prodem's training strategy, like its hiring strategy, changed so little over time demonstrates the extent to which Prodem believed that its investment was worth it.

Motivating Performance and Commitment

Once Prodem had hired and trained its employees, its next challenge was to keep them interested in being a part of the institution and to encourage constant improvement in their performance. Prodem met this challenge primarily by creating a work environment that valued and encouraged human development—the development of both clients and staff.

A Development Focus

Through a constant stream of formal and informal training, Prodem's employees could improve their technical knowledge and their interpersonal skills. They were entrusted with responsibility and decision-making authority. They were given the freedom to learn by doing, to experiment, and to come up with creative ways of accomplishing tasks. Staff appreciated these opportunities and the confidence the institution placed in them, and they worked hard to prove that they deserved such treatment. They remained committed to Prodem at least in part because they expected similar opportunities would be made available to them in the future.

"Being a part of something bigger than ourselves and building something that can outlast ourselves are important cravings."

– Robert Tomasko, in "Go For Growth"

Prodem's employees were also expected to contribute to other people's development.

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A typical banker would not have been motivated by such an offer, but Prodem did not hire typical bankers. It hired activists, sociologists, former priests, and others who were committed to social change. For them, it was extremely motivating to be employed by an institution that helped its staff and, in particular, its clients to develop. By providing microentrepreneurs with access to capital and supporting their efforts to make their economic ideas a reality, Prodem's employees believed they were making a contribution that would have an important and lasting impact.

"Instructions didn't just arrive at my desk saying, 'you have to fire so-and-so.' I was always part of the decision. I felt important."

– Eliana Otondo

Of course, it was not sufficient for Prodem to simply provide opportunities; it had to encourage staff to take advantage of those opportunities. On a professional level, Prodem did this by recognizing and rewarding achievement. When employees did a job well, they were complimented and given a chance to share what they learned. They were often given additional responsibility and some were promoted. Because their efforts were recognized, Prodem's employees developed pride in their work and were motivated to take advantage of opportunities that would enable them to continue contributing to the excellence of the institution.

Also important was Prodem's attitude towards failure. When employees erred, they were allowed to learn from their mistakes. Managers encouraged staff to use their errors to identify institutional or personal weaknesses and to strengthen those areas to avoid similar mistakes in the future. In general, employees were not fired for making mistakes; they were fired for refusing to learn from them, or for refusing to make an effort to succeed in the first place.

"Employees give extra because managers make them feel good about doing so. They feel like they're making an important contribution."

– Juan José Balderrama, Department of Organizational Development

Another strategy for encouraging staff was to emphasize the impact that their performance had on the institution and its clients. Led by Otero's example, managers regularly commented on the importance of each employee's contribution. They pointed out what a big difference their work made in the lives of individual clients and generalized about the impact that Prodem was having on Bolivian development in general. They made sure staff knew that they were an integral part of that success.

Managers also conveyed to their employees that being an integral part of something implied a degree of responsibility. Each staff member had the power to act and to make decisions that either furthered or hindered Prodem's mission. Understanding their potential to impact the course of events, employees were motivated to protect the institution's best interests, to care for its needs, and to contribute to its development.

On a personal level, Prodem encouraged its staff by creating a work environment that people enjoyed. It celebrated birthdays and anniversaries, organized sporting events and sponsored holiday dinners to give staff and their families an opportunity to interact on a social level. The members of individual branches and offices often gathered informally to share an empanada (a meat pie) in the morning or a cup of tea and a local pastry in the afternoon. It helped as well to have leaders like Otero and Bazoberry running the show, both of whom were an awful lot of fun. Their enthusiasm and good humor rubbed off on staff throughout the institution.

"Almost everyone at Prodem enjoys themselves – and they pay us to enjoy ourselves."

– Javier Bascope, Operations Manager, Southern Region

Prodem also worked hard to create a work environment in which individuals felt comfortable taking risks and making difficult decisions. Taking a tip from Maslow, it recognized that employees needed to satisfy their basic needs and family requirements before they could pursue other goals, so it offered benefit packages that included a competitive salary, health insurance, family and vacation leave time. It gave employees up to one day per month to attend to personal tasks that could only be accomplished during business hours or in more major cities of the country. It also clearly outlined the terms of employment so staff members could experience a sense of job security.

As part of its investment in an institutional culture based on trust, respect, and openness, Prodem took care in building relationships with staff that embodied that culture. For example, every once in awhile managers took individual employees to lunch so that they could get to know each person's interests and aspirations and understand better their strengths and limitations. This one-on-one time increased communication and trust between employees and their mentors, and made it easier both for problems to be discussed and for solutions to be found. Prodem's institutional

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Overcoming Obstacles

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Adjusting the Incentives

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culture provided a supportive environment that made it much easier for employees at all levels to consider and pursue development opportunities.

Overcoming Obstacles

Using these strategies, Prodem motivated its staff and sustained institutional momentum throughout most of its history. Even during the transition period after the creation of BancoSol, the decline in morale was due more to the temporary withdrawal of motivational elements than to a change in the motivational strategy. Employee expectations remained constant: staff wanted to be part of a successful team, they wanted a clear vision of where their institution was headed, and they wanted to be rewarded for their work. When a new leadership team was consolidated in 1993, Prodem regained momentum by applying the same motivational strategies it had used previously. It promoted a new executive director from within the institution who was already familiar with these strategies and knew how to make them work.

> *"When you see Prodem as yours you take care of it."*
>
> *– Jorge Arias*

As alluded to in previous chapters, however, Prodem's motivational strategies were tested over time. What is interesting for the outside observer is how Prodem responded and what it learned as a result of its experimentation and adaptation process.

Adjusting the Incentives

The first of a series of challenges came in 1994-95 when Prodem began rapidly expanding in rural areas. Being isolated, with poorer infrastructure and greater distances to travel between clients, rural branches provided less welcoming environments for employees than urban branches. This reality led Prodem to seek new ways of encouraging staff to remain committed to the institution in those new circumstances.

> *"How did I motivate others? By passing on the culture just as I had learned it."*
>
> *– Eliana Otondo*

For the first time in its history, Prodem experimented with an incentive scheme for staff in rural areas. The program was originally designed as a monthly bonus to award individuals who met certain performance standards, but Prodem quickly learned that this type of incentive had a negative impact on team performance and encouraged a short-term outlook. As a result, in 1996, it made the incentive an annual bonus awarded for branch performance. All members of a branch received a bonus if their branch met certain performance targets. The largest bonus was worth an additional month's salary.

The incentive system was generally successful in motivating staff, and the majority of rural branches consistently met their performance goals. Nevertheless, the system continued to have negative side effects. It discouraged staff rotation and reduced cooperation between branches, since employees who agreed to spend time in a branch with problems reduced their chances of obtaining a bonus. There was an increase in the number of staff fired because of corruption or for repeatedly breaking Prodem's methodology and rules. Since some branch environments were riskier, less developed, or more isolated than others, the incentive system also generated tension between those who were perceived to have received a bonus because they worked in a good environment and those who failed to earn a bonus even though they worked extremely hard to improve the performance of their branch. In such cases, the incentive system discouraged rather than encouraged staff.

Prodem's leadership decided to eliminate the branch bonus program and instead offer incentives for the performance of the whole institution. Over the next three years, it raised the salaries of rural employees by the amount of the incentive and decreased the bonus amount. It also announced plans to design a reward system that would allow employees to share in the annual profits generated by the institution.

Promoting from Within?

A second challenge arose in 1997 when Prodem reorganized its structure to manage its aggressive growth. It created a new layer of middle management at the regional level that it filled primarily with individuals from outside Prodem. The decision to fill the newly-created positions with "outsiders" rather than "insiders" deeply affected the institution's relationship with its staff. Employees expected that their opportunities within Prodem would grow as the institution grew. When Prodem created new management positions and chose not to fill them from within, staff felt their social contract with the institution weakened. Individuals who thought they were next in line for a promotion felt betrayed. Many began to doubt whether they had a future within the institution.

Prodem's leaders recognized their employees' dismay and the dangerous impact this was having on staff morale. They responded by explaining the reorganization in a manner that simultaneously increased staff understanding of the decision and placed a new twist on the institution's motivational strategy. They stressed that promotional opportunities still existed and always would exist. They also made it clear

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that they preferred to recruit managers from within the institution's ranks, but emphasized that they could only do so with employees' cooperation. In this case, Prodem had been forced to hire from the outside because it could not find individuals with the skills it needed within the institution. If employees wanted to be promoted, they would have to develop the skills necessary to assume the responsibilities of a new position. Even in existing positions, job responsibilities and standards would grow as the institution grows, and employees would have to take the initiative to grow as well, or else make themselves obsolete.

"Prodem doesn't give you things; it gives you responsibility."

– Javier Bascope

The new motivational approach involved both positive and negative incentives. Opportunities were available, but promotions—and even job security—depended on employees' willingness to improve their performance. Prodem adopted this carrot and stick strategy to encourage employees to be more internally driven and to set higher goals. It hoped to inspire an attitude among its staff that would provide the institution with a more permanent foundation for growth. It attempted to shift staff expectations away from assumptions about what was owed to them based on their close personal relationship with the institution, and towards an understanding that opportunities are earned through a professional relationship between partners striving for a common goal. The new approach was fairly well received, but there was some concern that by professionalizing its relationship with employees, Prodem created distance that did not exist before. The distance might succeed in motivating performance, but it could also erode the loyalty and trust that previously motivated commitment.

In a Competitive Environment

A third challenge to Prodem's motivational strategy, an increasingly competitive environment, began brewing in the mid-1990s. For years, a weak labor market offered few alternative professional opportunities to Prodem's employees. Turnover was practically nil during the first five years of Prodem's existence and it remained below ten percent until 1995. This was, in part, due to the way the institution motivated its staff, but it was also due to the lack of opportunities elsewhere. As competition in the microfinance sector increased, more jobs became available to Prodem's highly trained employees. As a result, the institution had to work harder to retain its human resources and to safeguard the investment it made in them.

Most employees remained with Prodem, but an increasing number chose to leave. According to exit interviews, employees resigned most often because they received a promotion or a better salary and benefit package from a competing microfinance institution. Some left to go back to school. A few left because they disagreed with changes taking place inside Prodem.

Table 7: Turnover Statistics

	1992	1993	1994	1995	1996	1997	1998
Total # of personnel at year end	85	141	129	134	159	237	309
Number of personnel contracted	60	101	47	22	55	113	113
Turnover	3	7	9	18	32	34	44
Resignations	2	4	3	9	14	18	18
Dismissals	1	3	6	9	18	16	26
Turnover (% of total personnel)	4	5	7	13	20	14	14

Note: Turnover statistics do not include employees who left Prodem through a branch transfer to BancoSol. Source: Prodem.

As seen in Table 7, an increasing number of employees were also asked to leave the institution. While acts of fraud, no matter how small, had always led to dismissal, poor performance only recently became a significant factor. Particularly at the branch level, an increasing number of managers were replaced because of their inability to fulfill their responsibilities. This reflected the institution's increased expectations as well as its difficulty in motivating staff to meet those standards. The competitive environment exacerbated both these trends by putting upward pressure on the expectations and by offering alternatives to managers who would rather work for another institution than have to go the extra mile at Prodem.

With the arrival of economic crisis in 1999, and the resulting restructuring and burnout, turnover within Prodem Oportunidad, FFP rose considerably in 2000 to an estimated 32 percent. Clearly, human resources were not being developed as anticipated, but how was the FFP to motivate performance and long-term commitment when so much about the future seemed uncertain and, from many perspectives, downright depressing?

The FFP has not yet defined a clear answer to this quandary, but a few planks of its game plan are already clear and are worth sharing. First, Prodem created a new logo, and its leaders plan to use that logo to promote a culture that is inspired simultaneously by old values and a new vision. While

> *"I'm not here because of what they pay me; I'm here because this is the only place that gives me the chance to make a difference."*
>
> *– Prodem employee*

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three-day vacation on the beach in
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For Prodem, however, th
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– Prodem employee

retaining its traditional focus on teamwork, the new culture defines the team to include employees, clients and shareholders, each of which is represented by a figure in the logo's swirling circle. Eduardo Bazoberry calls the philosophy behind the logo, "participative capitalism," and when asked to explain what it means he replies using an old Prodem saying, "for me to win, everyone must win." Bazoberry believes that a more participatory version of capitalism is not only possible, but is the only one that is sustainable in the long term. It is the vision around which Bazoberry hopes to rally his organization.

Fondo Financiero Privado S.A.

If the first part of the plan is seen as the "mística," or intangible inspiration, the second part of the plan provides the "mástica," or tangible rewards for a job well done. Prodem has long recognized the need to balance tangible and intangible incentives and this is reflected in the complex and creative matrix of incentives that it has crafted to help employees fulfill a variety of needs ranging from shelter and security to acceptance and self-fulfillment. The matrix includes financial incentives, such as profit-sharing and market-responsive salary adjustments, and an array of non-financial incentives, such as health benefits, achievement awards and the opportunity to take a sabbatical after ten years of service. Last year, staff members from the five best performing branches received a three-day vacation on the beach in Argentina for themselves and their spouses.

"It makes all the sense in the world to make your employees your partners; they're the best resource you have."

– Eduardo Bazoberry

For Prodem, however, the cornerstone of its new plan is the employee fund, a benefit offered by no other financial institution in Bolivia. Ten percent of the FFP is indirectly owned by employees through that fund, which serves both as a pension fund and, if employees remain with Prodem for twelve years or more, an avenue for direct participation in the ownership of the company. Prodem's management believes that the best way to motivate long-term commitment is to make employees long term partners in the institution's development, and that is why it fought so hard for the fund's creation. Will the individual ownership stake be large enough and tangible enough to serve that purpose? One can only wait and see.

∽ CHAPTER 4 ∾
Organizational Structure

The third and final component of an organization's architecture is its structure. By providing the physical framework within which an institution pursues its mission and develops its human resources, structure links the elements of design together to create a foundation for institutional development.

Prodem's ability to sustain intense levels of growth during much of its history reflects the degree to which its organizational structure succeeded in fulfilling this mandate. Its structure organized staff in a manner that reflected Prodem's cultural values and enabled its employees to effectively and efficiently carry out their functions. If this structure had been weak at the governance level, Prodem's operations would never have benefited from the quality of leadership that has directed the institution thus far. If it had been weak at the operational level, the ambitious plans that were laid out by Prodem's leadership could never have been implemented. It was Prodem's ability to develop capacity at both levels that resulted in its architectural strength.

Prodem's Leadership

When Prodem's founders decided to launch a microenterprise program in Bolivia, they chose to do so by creating an institution, not by funding a project. This decision proved critical for Prodem because it focused attention on the need to define a strong, independent and sustainable leadership structure from the beginning. Prodem was born as a Bolivian non-profit, non-governmental foundation with an independent board of trustees and a professional manager that together provided the solid guidance Prodem needed to pursue its challenging goals.

At the Governance Level

Although different individuals have been involved over time, Prodem's governance structure remained essentially unchanged between 1987 and

2000. It consisted of a Members' Assembly, an Administrative Council, and an Executive Committee.

The Members' Assembly was Prodem's highest decision-making body and was responsible for defining the institution's policies and strategies and for approving its budgets. From the time Prodem was founded until the launch of the FFP, Prodem's Assembly consisted of fourteen members: twelve national institutions and individuals and two international institutions.

"Continuous innovation occurs largely because a few key executives have a broad vision of what their organizations can accomplish for the world and lead their enterprises toward it. They appreciate the role of innovation in achieving their goals and consciously manage their concerns, value systems and atmospheres to support it."

– James Brian Quinn, "Innovation and Corporate Strategy: Managed Chaos"

One glance at the complete list of members provided in Table 8 and it is clear that Prodem was backed by a group of powerful and influential players that included some of the country's largest banks and businesses, several high-ranking political appointees and even a former president.

This kind of backing was not necessarily a good thing. If members had used the institution as a tool for political gain, Prodem's goals would never have been met. Since, however, members served Prodem primarily as businessmen and advisors, they significantly enhanced the institution's ability to achieve its goals. Their expertise, experience and influence were particularly useful in helping the Foundation raise funds and gain the political and regulatory support necessary for the creation of BancoSol and Prodem Oportunidad, FFP. This is not to say that the individuals who became involved in Prodem did not have a personal interest in doing so. They did.[41] But personal agendas were kept in line by other actors in the leadership structure and by a general willingness among members to accept the long-term benefits of participation in lieu of short-term gains.

Once a year, Prodem's Assembly designated the seven members of its Administrative Council, which served as a board of trustees. The first Council was appointed in October 1986, with Fernando Romero as its president. Prodem has had only one other president since that time. Roberto Capriles assumed the responsibility from 1989 until 1994, when Romero returned to the chair. Prodem's Administrative Council had two

[41] For an interesting analysis of the factors motivating Prodem's members to action, see Elizabeth Rhyne, Mainstreaming Microfinance.

main functions: to serve as the institution's legal representative, and to oversee its performance. It reviewed and approved the executive, administrative and operational actions proposed by management, and ensured the efficiency and adequate development of the institution. [44]

Table 8: Members of Prodem's Assembly

Institutional Members	Representatives
Banco Industrial S.A.	Julio León Prado, President
Banco Boliviano Americano	David Blanco, President (and former Minister of Finance)
B.H.N. Multibanco	Fernando Romero, President
Bolivian Confederation of Private Enterprises	Jose Luis Camacho, President; and Javier Murillo, Executive Secretary (currently serving as Minister of Foreign Relations)
Chamber of Industry and Commerce of Santa Cruz (CAINCO)	Luis Fernando Terrazas, President
Intermaco	Fernando Romero, President
Comsur	Jaime Urjel, Gonzalo Sanchez de Lozada
Estalsa	Carlos Iturralde, President
Acción International	Bill Burrus, Executive Director Michael Chu, President
Calmeadow	Martin Connell, President
Individual Members	**Affiliation**
Luis Eduardo Siles	Board Chair, Banco Boliviano Americano
Fernando Romero	President, Inversiones Bolivianas S.A., and former Minister of Planning and Coordination
Fernando Illanes	Executive President, Empresa Boliviana de Administración
Gonzalo Sanchez de Lozada	Former President of Bolivia and Co-founder of Comsur
Carlos Iturralde	President, Estalsa, and former Minister of Foreign Relations

The Executive Committee was a three-person subset of the Administrative Council, elected by the Council once a year to provide management with the oversight and support necessary on a day-to-day basis. Whereas the Administrative Council and Members' Assembly met with management only twice per year, the Executive Committee was in constant touch with Prodem's Executive Director. It made decisions and addressed policy issues that had been delegated to it by the Council. It also helped management prepare for meetings with the Council and Assembly and played a key role in directing the activities and discussions of those meetings.

Prodem clearly benefited from a well-defined governance structure and from the participation of extraordinary individuals in that structure. There was an additional factor, however, that made its governance strong over the long term, and that was the presence of a leader within the structure who championed the institution's cause and motivated everyone else to stand behind it. That leader was Fernando Romero. Romero envisioned Prodem's potential during his conversations with Jack Duncan and Bill Burrus in the mid-1980s and he has now spent more than fifteen years guiding Prodem toward that vision. He brought together the group of businessmen that heard Acción's presentation in 1985. He cajoled them into launching an institution. He then got in touch with USAID's mission in Bolivia and convinced it to help fund the idea. Since Prodem's founding, Romero has been present at the decision-making table every step of the way, pushing the institution to remain faithful to its mission and to pursue its objectives in the most strategic way possible. If there was a thread that wove Prodem's governance together over the years, it was Romero.

At the Management Level

The other half of Prodem's leadership was provided at the management level, primarily through the professionals hired to serve as Prodem's executive director. The executive director was responsible for the institution's day-to-day operations and answers directly to the Members' Assembly. As with the presidency, Prodem had only two executive directors between 1987 and 2000. Pancho Otero launched the institution and remained its guide until he became full-time CEO of BancoSol in 1993. Eduardo Bazoberry led Prodem from 1993 until the launching of the FFP.

Prodem was both wise and fortunate to recruit highly qualified executive directors who not only fulfilled their operational responsibilities, but also knew how to guide the development of the institution's culture. Both Otero and Bazoberry are renowned for their vision, charisma, commitment, and the respectful way they treated all staff. They easily motivated the institution to dream, to turn

> *"Eduardo is a born leader."*
>
> *"Sergio makes things happen."*
>
> *"Pancho motivates you so much you have to stop yourself sometimes from acting too rashly."*
>
> *– Comments made by Prodem employees*

[44] Prodem, "Twelve Years," 10.

those dreams into reality, and to make every staff member feel like an important player in that process. They set examples for employees through their attitudes and actions, and they focused everyone's energy on strategic priorities for the future.

Otero and Bazoberry had something else in common, and that was their ability to identify and hire talented individuals to support them within the institution. Chapter 3 discussed Otero's strategies for recruiting staff in some detail; it is worth noting the extent to which Bazoberry continued in the same vein. Both men had an eye for people. They knew the kind of person who would succeed within Prodem and they knew the kind of manager Prodem needed to succeed. They took great care in finding just the right person to sit in the office next door. Once they found that person, they convinced him or her to join Prodem and then worked hard to build a management team.

> *"Each leader has to make sure he has a solid base below him."*
>
> *– Marcelo Maella, National Administration & Finance Manager*

Amazingly, the spirit that Otero, Velasco and Usnayo had in 1987 seems present still in Bazoberry, Prudencio and Maella. Despite the growth of the institution, the increased complexity of operations, and the more complicated external environment, Prodem's management team works together like the gears of a clock. They rely strongly on the different skills, perspectives and approaches that each one brings to the table. Sergio Prudencio, Prodem's Operations Manager, is an optimist, a doer, a guy who can make things happen. He is the one who jumps into the lake when he gets wind of an idea that he thinks will work. Before Product A is out the door, he is already talking about Products B and C. Sergio knows Prodem inside and out. He has crawled under just about every rock the institution has to crawl under. With a background in rural development and a very down-to-earth personality, he has established excellent relationships with employees throughout the institution.

Marcelo Maella, Prodem's Administration and Finance Manager, is a realist and a pragmatist. He is more cautious. Before he jumps into a lake he measures to see how deep it is, calculates whether he can make it to the other side, investigates to see if he can obtain financing to build a boat to carry Prodem across. Maella comes from a regulatory and financial background. He is well-spoken and level-headed, and has built very strong relationships with Prodem's external stakeholders, with the Superintendent's Office, with commercial banks and donors. He provided

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the expertise necessary to transform Prodem's rural lending operations into an FFP, expertise that Prodem had to obtain largely from the outside when it transformed its urban lending operations into BancoSol. Maella's credibility in the financial sector has helped both Prodem and the FFP earn their reputation as serious, viable institutions.

"My goal is that every employee leave my branch as a leader."

– Angel Andrade, Branch Manager

For Bazoberry, Prudencio and Maella are an excellent combination. As a team, they are passionate, but not rash. Reasoned, but not risk-averse. They complement each other. Among other things, they provide him with the balanced sounding board he needs to test his own thoughts and ideas. Together, the three of them can make visionary, but intelligent decisions.

Bazoberry is justifiably proud of being able to say that he could resign tomorrow and Prodem would continue to operate without blinking an eye. He says this, and employees say it too, because of the strength of the management team within which Bazoberry works. Successors have been groomed. This philosophy of preparing future leaders exists throughout the institution and is another reflection of the team spirit that pervades Prodem. Rather than fear competition from their colleagues, managers have worked hard to create the leaders Prodem needed to fuel its

Figure 14 : Prodem's Leadership Structure

institutional growth. This policy helped make the institution strong and also provided stability because it meant that leadership vacuums were rare. As long as someone was always groomed for leadership, a manager could be absent due to training or sickness and his office would still run relatively smoothly. There was always someone else to step in and fill his or her shoes.

Powerful Interaction

Prodem's governors and managers each provided the institution with an important element of leadership. That leadership would not have been as strong or as effective, however, were it not for the ability of the actors involved to interact with each other in a productive and fluid manner. It is worth taking a look at some of the factors that facilitated their constructive interaction.

First, each member of Prodem's leadership was tied to at least one other through a personal relationship that existed prior to the founding of the institution. Some of the connections were business-related, others were political, and some dated back to university. These personal relationships facilitated a level of trust, understanding and risk taking that would not have existed among strangers.

Second, the leaders realized, somewhat begrudgingly, that they needed each other. The businessmen sitting on the Administrative Council and the activists running the institution's operations would not normally associate with each other. They had different interests and priorities and not a whole lot of respect for the way the other camp looked at things. Nonetheless, in the context of the Prodem experiment, they knew they would have to depend on each other to make it work. Bankers had no intention of rolling up their shirtsleeves and heading out to the markets to make $50 loans, while activists had no desire to spend their days in an office trying to figure out where they could come up with financing for their loans. Yet everyone had an interest in figuring out whether it was possible to jumpstart Bolivia's economic development through microenterprise promotion. Thus, they agreed to sit around the table and make a reasonable effort to communicate. The fact that actors with money, social sympathies, political weight, and technical expertise all gathered together to launch Prodem was critical to its success.

Third, each component of the leadership structure knew and, for the most part, respected its roles and responsibilities. Governors governed and managers managed. This is not to say there was an absence of power struggle within Prodem, but rather, that the structure provided checks and balances that avoided a total concentration of power in any one individual

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Fourth, Prodem's leaders created, in general, an environment of openness that allowed the perspectives, arguments and insights of different actors to be heard and discussed before decisions were made. It was not an entirely benevolent environment. Prodem's leaders were, almost without exception, strong characters with strong opinions who were determined to have them heard, but it was their determination that ensured ideas would flow and issues would be debated. This kind of debate led to a more informed decision-making process within the institution.

Finally, Prodem's leadership understood the importance and positive role of change. Rather than fight it, or try to protect the institution from its destabilizing effects, they incorporated it into the institution's culture, structure and systems. Prodem could not have produced the innovation known as BancoSol were it not for the strong support that all leaders lent to the transformation process. Their constructive attitude toward change helped make Prodem's paradigm breaking possible.

Operational Structure

While Prodem's leadership structure remained remarkably stable over the years, its operational structure changed significantly. The scale and type of growth experienced, particularly after 1992, necessitated these changes. Prodem could not continue operating in its original structure any more than a grown man could wear a child's clothing. It had to adapt its shape and organization to meet its changing needs. What makes the story interesting is how it adapted and how the changes enabled the institution to prepare for and respond to growth.

Getting Started

As noted in Chapter 3, Prodem's operations got rolling when Otero and his first two employees ventured into the field to recruit Prodem's first clients. There was no visible structure. The relationships between Otero and his employees were personal, direct and informal. They all performed the same functions. Once they found a market niche and the program began to grow, more people were hired, but the structure remained the same. Otero played more of a management role, but his staff had equal and direct access to him.

Figure 15: Prodem's Operational Structure 1987

This structure was no accident. Otero deliberately set up this type of interaction to encourage development of the cultural values described in Chapter 2. Decision-making was decentralized and policies were formed by consensus whenever possible. Employees did not adhere to rigid job descriptions, but rather, organized themselves into teams and distributed tasks based on each employee's abilities and the particular challenges at hand. At the branch level, field workers were trained in all of the branch's functions and rotated tasks among themselves. Loans were approved in credit committees, which served as both a mechanism for collective decision-making and a check on the individual power of any one staff member.

Besides being flat and flexible, Prodem's initial structure was also field-based. Its offices were located in the areas where its clients lived and worked, and information largely flowed from the outside in. Being there made it much easier to build relationships with its clients, to get to know their environment, needs, hopes and expectations. It helped the institution build a methodology that was appropriate for that environment, and indeed, to become part of that environment.

The flat and flexible structure, correctly positioned, gave Prodem the framework it needed to experiment. It facilitated intellectual as well as operational flexibility, allowing problems to be solved through trial and error, with the input of anyone and everyone who had a creative idea and a plan for implementing it. Having direct access to the executive director and a concrete role in decision-making processes both empowered and motivated staff.

Expansion and Specialization

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– Eliana Otondo

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Expansion and Specialization

When asked what Prodem's organizational structure looked like during its first years, Otero did not offer an organizational chart or a list of positions and their responsibilities; he simply rattled off the names of Prodem's first core group of employees. He assigned them no titles and placed them in no particular order. He just commented that those were the people who built Prodem in its early years.

As the number of clients grew, Prodem's structure expanded. It remained flat and fairly flexible, but individuals started to specialize, particularly in the areas of administration, accounting, systems and human resource development. Employees were contracted to work in a specific area, but they were expected to chip in wherever Prodem needed them. A person could be hired to work in human resources, but if a long line began to form in front of the cashier, that person would step in and help serve clients at the cashier's window. If a client came to the door and no field officers were around, he (or she) would serve that client the best he could. He would need to know Prodem and its services well enough to answer the client's questions and concerns. Employees were still expected to be generalists.

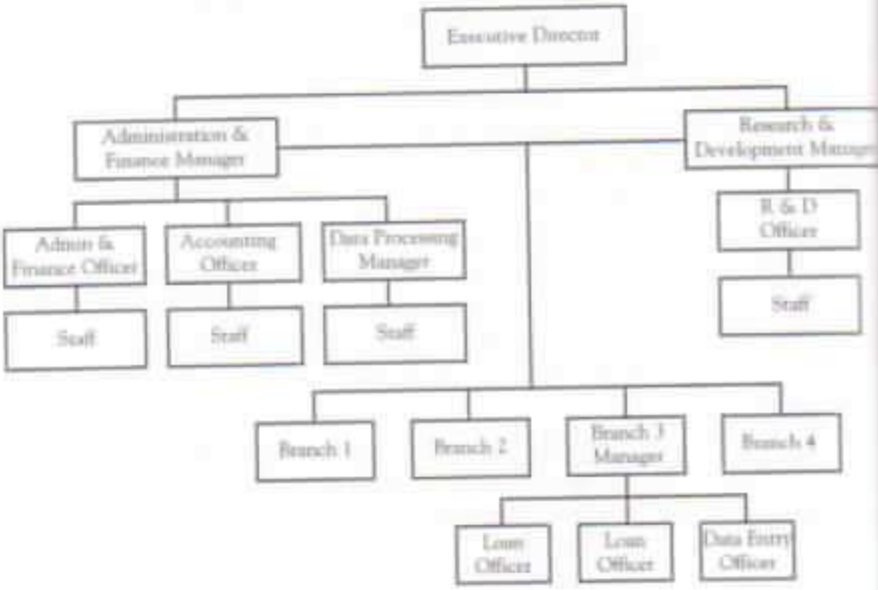
Specialization increased gradually as Prodem opened branches outside the capital city. Once branches were opened in El Alto, Santa Cruz and Cochabamba, it became necessary to distinguish between officers that served the branch and the national levels. By 1990, each branch employed a manager and field officers and that was it. They rotated collection, disbursement, cashier and marketing tasks among themselves. The credit and accounting manager, administration and personnel manager, data processing manager and their assistants were found at the national level. However, since national level staff continued to work in the same office space as the La Paz branch staff, there was a great deal of interaction between them. As before, if branch staff were in the field, and a client came to the door, national level staff responded.

"You would never tell a client to come back later."

–Eliana Otondo

Over time, the branch structure changed remarkably little. In 1992, a data entry person joined the branch level staff as part of the process of implementing the new Prodem/BancoSol information system. This position made sense in branches that were about to be sold to BancoSol, but it did not make sense for new branches opening up in rural areas. Thus, the position was eliminated and Prodem's newly-created systems department designed an information system that could be operated directly by field officers. In 1995, some of Prodem's branches experimented with the addition of an accounting and administration officer, but this position was also eliminated. By 1996 sufficient advances were made in Prodem's systems technology that it became unnecessary for branches to bear the expense of a full-time officer.

Figure 16: Prodem's Operational Structure 1992



Specialization at the branch level was largely unnecessary as long as Prodem's products remained relatively homogeneous. When individual loans were introduced in 1997, some branches chose to have one loan officer specialize in that product, but doing so was not institutional policy. Only in 1999, as part of the preparations for launching the FFP, did specialization begin to take root at the branch level. All branches now have a full-time cashier and some have a commercial officer who takes responsibility for marketing and administering Prodem's non-credit products.

The major changes in Prodem's operational structure occurred above the branch level. As the number of employees and the physical distance between them grew, it became increasingly difficult, if not logistically impossible, for Prodem's national staff to provide branches with the level of support they needed. It also became harder for management to collect the

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Growth made it possible for Prodem to hire individuals at the national level who possessed experience in a specific functional area and could use that knowledge to advise the institution's operations across the country. In 1993, Prodem created a systems department and began hiring information technology
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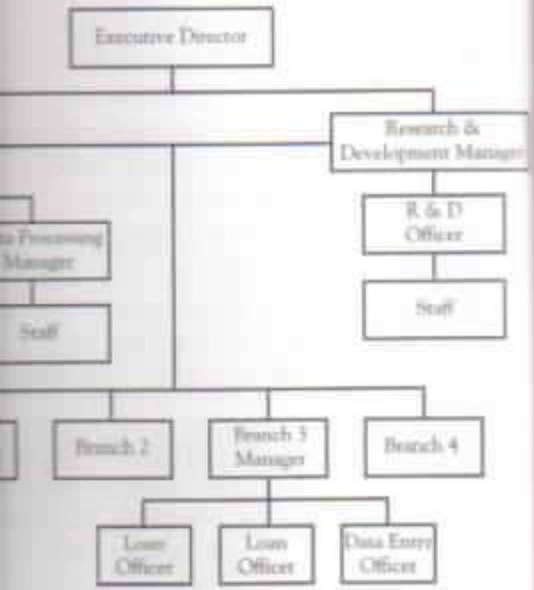

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information it needed to effectively run the institution. At the same time, the higher cost of lending in rural areas and growing competition put Prodem under pressure to operate more efficiently. It attempted to respond to all of these challenges simultaneously, first by hiring more technical specialists and second, by creating a regional level of management.

> *"Having somebody who can do a really good job on asset liability management becomes more important when your profits are squeezed by competition and you're trying to get your rates down as low as possible."*
>
> *– Elisabeth Rhyne, in "Conversations With the Experts"*

Growth made it possible for Prodem to hire individuals at the national level who possessed experience in a specific functional area and could use that knowledge to advise the institution's operations across the country. In 1993, Prodem created a systems department and began hiring information technology specialists. In 1995, it created a human resources department; in 1998, a legal department and an internal audit department. In 1999, it hired a marketing expert. These technical specialists worked closely with the executive managers, providing them with the skills, resources, and extra manpower to serve individual branches better and to monitor the institution's performance as a whole. By focusing on specific technical areas and processes, these specialists helped Prodem identify and implement ideas for operating more effectively and efficiently.

Adding Another Layer

As a second structural response to growth, Prodem incorporated a middle layer of support and management between the national and branch levels. In 1993, it created offices in each of Bolivia's nine geographic departments staffed by a departmental manager, an accounting officer, an administrative officer and an information officer. Unfortunately, these departmental offices proved to be weak. Since the departments varied in size and population concentration, the number of branches in each was not particularly well balanced. Their organization did not supply sufficient economies of scale to enable each office to provide a sustainable set of support functions. Departmental managers were promoted from within the institution and often lacked the experience and skills to manage both the financial and service side of the institution's operations. As a result, national level staff continued to play a significant role in supporting both the departmental offices and individual branches.

Learning from this experience, Prodem reorganized its operations again in 1997 to create four relatively balanced geographic regions in the north, south, east and west of the country. Each regional office was staffed with a regional manager, an information officer, an accountant, an administrative officer, and two or three operations managers at the departmental level. Each office was charged with supporting the branches within its region and collecting and analyzing information for use by the national level. The regional managers played the mentoring, motivating, problem-solving, monitoring role previously played by the national managers. Branches received stronger and more continuous support and follow up. Expansion could occur at a faster rate. The reduced demands on national level staff left them free to focus on broader institutional needs such as strategic planning, competitive market analysis, and building strong relationships with external partners.

The reorganization, however advantageous, was difficult to implement. Prodem had to analyze carefully which services would be provided at the national and regional levels to avoid a costly and possibly conflictive duplication of services. It organized the regions anticipating the institution's future growth and made investments in infrastructure and staff before the volume of its operations actually warranted it. This was expensive and risky, but it was also strategic because when Prodem did grow, its structure was ready to support that growth.

Perhaps the most difficult part about implementing this change was selecting the personnel who would become regional managers. Although Prodem had a tradition of promoting from within, it could only identify one employee who possessed the combination of skills, leadership potential and personal drive necessary to fill the regional position. It hired the remaining three managers from outside the institution: two BancoSol employees who had worked with Prodem before the creation of the bank and were therefore quite familiar with its operations and culture, and one professional from the commercial banking sector. Each was hired for a specific technical expertise (i.e. credit analysis, arrears management, and marketing) in addition to their general professional and managerial abilities in an effort to strengthen the institution's knowledge in those areas.

Figure 17: Prodem's Operational Structure 1999

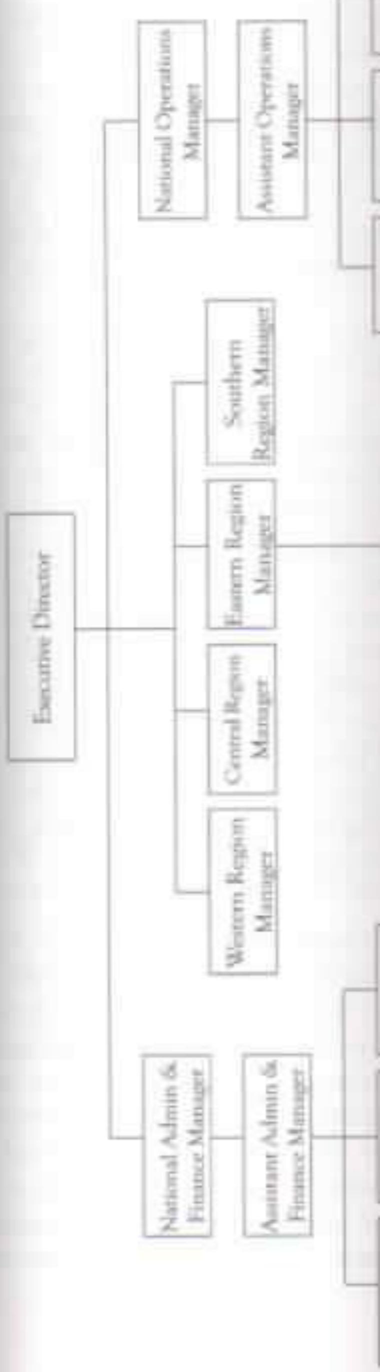

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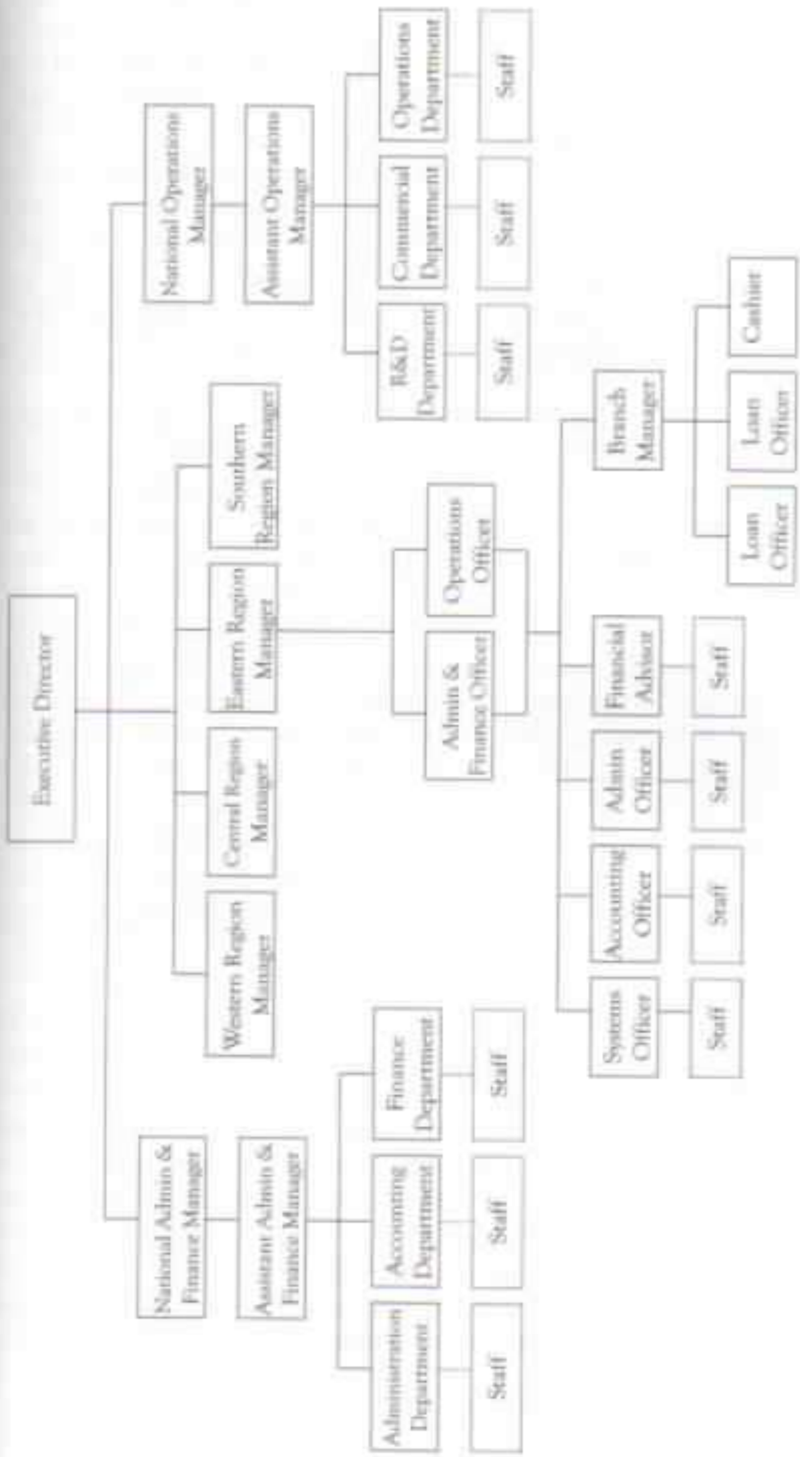
Figure 17: Prodem's Operational Structure 1999



Prodem had to work hard to sell this reorganization. Despite explanations and sales pitches by the institution's leadership, employees were reluctant to accept the change. The transition was particularly difficult for departmental managers who were essentially demoted and saw much of their authority usurped by the new regional managers. In one case, a departmental manager left in protest of this decision and took 15 employees with him, leaving entire branches almost completely un-staffed. Two years after the reorganization was implemented, the institution had largely recovered from the backlash and employees were speaking positively about the change. Regional managers were finally gaining employees' trust. They had demonstrated the value they were capable of adding and were playing a critical role in preparations for the launch of the FFP.

Interestingly, while the addition of a regional layer of management proved effective for Prodem, the original idea of creating a more ambitious structure of support at the regional level proved inefficient. In 1999, Prodem was still experimenting with decentralization, moving all but one of its human resource staff to the regional level in attempt to make them more accessible to employees and more sensitive to regional needs. The decentralization was not very effective, however, because it weakened the human resources team and fueled the tendency toward regional isolationism rather than strengthening institutional commitment to Prodem. It was also costly, and when the recession entered its second year, the human resources function was re-centralized. In 2000, the finance and administration functions that had been carried out at the regional level were either centralized at the national level or decentralized to the branch level. Doing so was cost–effective given recent advances in Prodem's information technology, and it supported Prodem's strategy of encouraging branches to perform more like business units.

Making it Fit

Comparing the three organizational charts provided in Figure 15 , Figure 16 and Figure 17 , it is clear that Prodem created a more formal and vertical structure over time. The clash that could have occurred between the organization's vertical channels of authority and its horizontal culture of teamwork and participatory decision-making largely did not occur because Prodem's leadership did a good job of introducing structural change in a traditional cultural package. Senior managers emphasized that teamwork, participation and growth were all important elements of the institution's culture, and staff had to be creative about how they made all of the elements a reality at the same time. Indeed, Prodem was becoming

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more vertical, but that did not mean that employees had to **treat** each other in a vertical manner. Even though there was less interaction between national management and branch-level employees, when the two did meet, they could and should meet with the same level of respect, openness and interest as before. Prodem's participatory processes should also remain intact. The decision-making and responsibility chain was more vertical, but all staff would continue to be a part of that chain.

"Everything small can be managed better."

– Jose Herrera

The fit between Prodem's structure and culture was strong enough to get the institution through the crises of 1999 and 2000. Staff were supportive of each other and did find creative ways to collaborate. In Prodem's western region, for example, five neighboring branches grouped themselves together as a "block" to assist one another with marketing campaigns and collection efforts. They found the informal collaboration to be quite useful, and other branches formed ad hoc blocks as a result.

The prolonged recession put pressure on both the organizational structure and culture, however. Prodem's structure became too heavy and too expensive to be sustained in the current environment and employees had to be laid off in the fall of 2000. The move was demoralizing for staff, who were already quite tired from the long period of contraction and difficult collections. Gaps began to emerge between Prodem's stated culture, its actual culture, its structure, and its human resource commitments. The emergence of such gaps is hardly surprising and does not necessarily bode ill for the strength of Prodem's design framework, but it does mean that the institution will have to devote more attention to making sure that there is coherence among the elements of its organizational architecture in the near future.

PART III

Adding Value

"Innovation is more than creativity. Creativity is about generating new ideas and concepts. For creativity to result in innovation, the change must result in added value through some form of implementation."

– Alan Mossman, The Innovation Journal

Prodem's organizational architecture provided it with a framework and a foundation. It defined what the institution wanted to achieve, with what resources, in what kind of structure and according to what values. This section of the document explores how Prodem applied that framework in pursuit of its goals. It aims to demonstrate that Prodem's success at breaking paradigms required more than just a new vision and a visionary leader; it required strategies of implementation that brought that vision down to earth and made it valuable in concrete terms for all of the institution's stakeholders.

The following three chapters examine the key processes, systems and relationships through which Prodem effectively identified and implemented new ideas. They explore the development of these mechanisms as well as the capacity they contributed to the institution. Chapter 5 begins with a focus on Prodem's use of information to inform and integrate its operational, financial, administrative and strategic planning activities. Chapter 6 examines the approach that Prodem used to design and deliver effective financial services. Finally, Chapter 7 considers the strategic alliances that supported Prodem over time and facilitated its access to both knowledge and funds.

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CHAPTER 5
Information Technology

Information has always been a valuable resource, but in today's Internet environment, the processing of information is also of major importance. Organizations must be able to discern what information is important to them, collect it efficiently, organize it effectively, and distribute it so that it gets into the hands of those who need it as quickly as possible. On this theme, Prodem offers an interesting example in two areas, first, with respect to its approach to information processing, and second, with respect to its utilization of technology to make that process more efficient. Both topics are explored in this chapter.

The Approach

Microfinance institutions often adopt a narrow approach to information that focuses on the specific data they want to collect and monitor. They typically build their information systems around their loan tracking software and combine that software with a financial or accounting package to keep track of funds. Prodem, by contrast, adopted a more expansive approach to information based on the way data flows—into, out of and within—the institution.

By focusing first on flow, rather than on the specific data it wanted to collect, Prodem built channels of communication that ensured a well-lubricated information machine. Some channels carried information within the institution, for example, from those involved in finance activities to those involved in operational activities, or from branches to the national office. Others distributed data and messages to stakeholders outside the institution, such as clients, donors, and suppliers. Still others gathered data from the external environment for use within Prodem. This network of communication channels encouraged both teamwork and participation because it focused on the flow of information, not the concentration of information in any one place. Everyone involved with

Prodem had the opportunity and the responsibility to contribute to the information flow. It was one of the primary ways in which Prodem brought its horizontal culture to life.

The initial focus on flow rather than on data also helped Prodem clarify why it wanted to collect and disseminate information. The open channels of communication facilitated dialogue about what kinds of information different parties needed and for what purposes. Essentially, Prodem managed information for six reasons: 1) to determine client needs; 2) to understand the market environment; 3) to monitor institutional performance; 4) to communicate data; 5) to minimize risk; and 6) to manage the institution's financial, physical and human resources.

Once staff members understood the purpose of gathering or disseminating a certain type of information, they had relatively little difficulty identifying, applying, and even developing mechanisms that could serve that purpose creatively and efficiently. Mechanisms were employed in different combinations and technologies were constantly improved upon in an effort to better serve a particular function. This approach built flexibility into Prodem's information system, which was important given the changing internal and external environment.

Table 9 illustrates some of the different mechanisms used by Prodem to gather and channel information in fulfillment of a particular institutional function. For example, Prodem used impact studies, focus groups, exit interviews with clients, staff evaluations, CAMEL and SWOT analyses,[*] regular meetings and a computerized information system to monitor performance. It did not rely on any one mechanism to do the job, nor did it use all of the mechanisms all of the time. It employed a combination of mechanisms to ensure that the institution could monitor its performance in the most effective and efficient way possible given a specific set of circumstances.

One might think that with so many mechanisms available for indiscriminate application, Prodem would spend an exorbitant amount of time chasing after information and sending it from one place to another. In fact, the opposite occurred because employees were free to choose the mechanism or mechanisms that they believed would be most useful in a particular situation. They were rewarded not for their choice of mechanism, but for the degree to which their choice of mechanism enabled the institution to fulfill a given function efficiently and effectively. In other

[*] CAMEL is a banking analysis that looks at five categories of quantitative and qualitative indicators of health: Capital adequacy, Asset quality, Management, Earnings, and Liquidity. SWOT is a strategic planning analysis that uses participatory methods to summarize an institution's Strengths, Weaknesses, Opportunities, and Threats.

Table 9: Mechanisms Facil

Function	Identify Client Needs	Understand Market Environment	Performance Monitoring
Mechanism	Subsector analysis		Impact Studies
	Focus groups		
			Dyna
	Exit interviews with clients		
	Social and economic evaluation	Market research	Key monthly performance indicators
	Observation		Staff evaluation
	Household surveys	Competitor profiles	Reg
			Compute
	Confirma-tion surveys	Diagnostic studies	CAMEL & SWOT analysis

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Table 9: Mechanisms Facilitating the Flow of Information

Function	Identify Client Needs	Understand Market Environment	Performance Monitoring	Communication	Risk Management	Resource Management
Mechanisms	Subsector analysis		Impact Studies	Written documentation	Contract design	Fixed asset register
	Focus groups			Training	Daily monitoring of arrears	Supply inventory
	Dynamic feedback loops					
	Exit interviews with clients			Social events	Internal and external audits	Dept of organizational development
	Social and economic evaluation	Market research	Key monthly performance indicators	Branch journal	Social and economic evaluation	Training
	Observation		Staff evaluation	Participatory decision-making	Verify info through field visits and multiple data sources	Team development officer
	Household surveys	Competitor profiles	Regular meetings		Clear credit guidelines and policies	Newsletter
	Computerized information systems					
	Confirmation surveys	Diagnostic studies	CAMEL & SWOT analysis	Visual aides	Clear job descriptions and org structure	Methodology reviews

words, it did not matter whether a credit officer got his message across using a poster or a training session. What mattered was whether he got his message across.

Although Table 9 presents a variety of different mechanisms, it is clear that Prodem found two to be particularly valuable in facilitating the flow of information: the dynamic feedback loop and computerized information systems. Prodem introduced these two mechanisms early in its history and they have been applied continuously ever since. Their importance to the institution warrants a more careful look at their development and implementation.

Dynamic Feedback Loops

Prodem's first step in encouraging a productive flow of information within the institution was to foster dynamic feedback loops. A dynamic feedback loop is a two-way flow of information that feeds off itself. It is an open and informal channel of communication through which one party shares information while the second party listens, and later responds. These loops existed among staff, between staff and management, and between staff and clients. Individuals chose with whom they communicated, when and how they communicated, and what they communicated about.

Dynamic feedback loops grew out of trust-based relationships. Pancho Otero never described them as such, but he brought dynamic feedback loops to Prodem. He introduced them by building trusting relationships with his staff, by encouraging them to share their ideas, problems and questions, by listening to what they had to say, and by offering feedback. He also made himself accessible to his staff, always left his door open, called staff members into his office when he came up with a new idea and asked them for their feedback.

More communication led to more trust and more trust led to more communication. As Prodem grew, its original team followed Otero's example and built relationships with new staff members in the same way that he had with them. They built similar relationships with clients, eventually establishing feedback loops with many of the institution's borrowers. Feedback loops became Prodem's most important tool in identifying client needs, monitoring changes, and developing products that could meet them. They facilitated the flow of ideas and lessons from the field to the national office where they could influence the definition of appropriate policies and strategies. They also served an oversight function by monitoring both staff and client performance. Clients who trusted Prodem and believed that the institution valued their opinions told credit

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officers what they liked and disliked about its service. Credit officers who developed dynamic feedback loops with their clients were better able to assess the level of risk inherent in offering them a particular set of loan terms.

Recognizing the importance of its feedback loops, Prodem made a concerted effort to keep them operating over the years. Supervisors actively solicited opinions from their staff, and managers made an effort to be physically accessible to all personnel, either through frequent trips to the field, through an open door policy at the office, or both. Although dynamic feedback loops do not require formal meetings, monthly meetings at the regional level and weekly meetings at the branch level did help to keep channels of communication open. In addition, all of Prodem's offices have a kitchen or common area where employees meet informally over a cup of tea or coffee, and field officers share one office, which also encourages interaction and discussion.

> *"I called Victor Céspedes to explain our need for a worksheet to register the buying and selling of currency. He told me to fax him a suggested template. In one week that form had been distributed to all of Prodem's agencies."*
>
> *– Javier Bascope*

One interesting development in the use of dynamic feedback loops was Prodem's recognition that the mechanism requires a certain amount of order to function well on a large scale, even though it functions informally. One of the reasons behind the new organizational structure in 1997 was to give more order to the informal flow of information that was leaving some employees "out of the loop." Before then, dynamic feedback loops were encouraged as a general concept; employees were free to establish feedback relationships with anyone in the institution they desired. This meant that staff built relationships with those whom they trusted, for whatever reason, and it resulted in a very random network of information channels. Without clear channels of communication and accountability, messages were sometimes lost or not shared with everyone; there were misunderstandings, and sometimes a lack of follow up.

Staff members are now expected to build feedback loops first and foremost with their immediate internal and external clients. Dynamic feedback loops with colleagues in another branch or with a national manager are not prohibited, but they are considered secondary. It will be interesting to see whether Prodem's feedback loops can be as effective when the parties involved have been told with whom they must eful look at their development and

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Computerized Information Systems[46]

Of all its information mechanisms, Prodem is best known for its in-house development of innovative computerized information systems. Just eight months after initiating its operations, Prodem had already developed a computerized fund-based accounting system that was considered to be the most advanced of any Acción-supported program.[47] It improved this system over time, integrating it with its portfolio system and creating additional reporting options that improved its ability to organize and analyze its performance data.

The system served it well until the creation of BancoSol. To incorporate new services such as savings, and to meet the Superintendent of Banks' reporting requirements, Prodem bought a new commercial information system. Although appropriate for the bank, the new system was too onerous for the needs of Prodem's rural branches. At the same time, the old system, which was developed in Quickbasic, was too inefficient. It duplicated client data with each new loan, it operated slowly, it could not export information between branches and the national office, and its continued use would have required the installation of additional memory, which was expensive.

> *"MFIs need information systems that are responsive to the needs of many different kinds of users, capable of managing an array of data, and flexible enough to adjust to changing requirements."*
>
> *– Eduardo Bazoberry*

Given the challenges it was facing in 1993, Prodem needed an information system that could help it overcome the poor infrastructure in rural areas, and the great distances people had to travel in order to carry information from rural areas to a city center. It needed something that was simple enough to be implemented directly by credit officers in the field and was flexible enough to accommodate the changes that would inevitably have to be made in response to the needs of rural markets. It needed a system that could do all this at a reasonable price. Since neither Prodem's old system nor BancoSol's system fit this

[46] This section draws heavily from Eduardo Bazoberry, "The Information Systems Challenge: How to Develop an Effective System without Putting the Organization into Bankruptcy!" in Establishing a Microfinance Industry, edited by Craig Churchill (Washington, D.C.: The MicroFinance Network, 1997).

[47] Jackelin, "Evaluation," II-2.

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The new systems provided Pro
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- consolidated information

[48] Bazoberry, "The Information Systems

description, Prodem developed a new information system to meet these goals.

Prodem chose to build its own internal systems capacity rather than rely on external computer consultants. It knew this path would be slower and could be more expensive than buying pre-packaged software, but it believed the investment would pay off by providing Prodem with the ability to maintain, adjust, and build upon its system as the institution grew and its information needs changed. Prodem hired an information systems team of well-respected persons with experience in the formal financial sector and a demonstrated ability to communicate with users of the systems they had developed.

Led by Miguel Lopez, this three-person team began in 1993 by getting to know the information needs of different types of users. They spoke with national, regional and branch management, finance and administration officers, loan officers, and even external users at the Office of the Superintendent of Banks, the national board of statistics and the Bolivian credit bureau. The participation of end users in the development process was critical for several reasons. First, it ensured that the system was designed to meet their needs. Second, it enhanced staff willingness to accept a change of systems by giving them a sense of ownership over the new product. Third, it provided an important opportunity to begin training staff in the use of information technology as a tool to maximize efficiency and productivity.[48]

Prodem's systems team designed two new software packages that were implemented in April of 1994 after 15 months of development and testing. Both were created in the FoxPro/DOS and LAN Novell environments and installed on 386 computers. The software system "Excelsior" managed client and portfolio information, while "Confin" managed all accounting and financial transactions. The two software systems were linked to each other, automating the transfer of information and the calculation of statistics. They were also linked to the institution's other computerized information systems, including the payroll, budgeting, office supply inventory and the fixed asset register.

The new systems provided Prodem with several other advantages:

- higher-speed processing that made it possible for each branch to serve up to 35,000 clients and disburse up to 5,000 loans per month;
- easier access to reports on a daily, monthly and annual basis;
- consolidated information from all branches;

[48] Bazoberry, "The Information Systems Challenge," 22.

- automatic back-up storage;
- automatic adjustments for exchange rates; and
- built-in mechanisms to prevent entry error and fraud.[44]

The services provided by the two systems are summarized in Table 10.

Table 10 : Services Provided by the Excelsior and Confin Information Systems

	Excelsior Portfolio System	Confin Accounting & Finance System
Branch Level	• Disbursements • Payments • Local statistics on default, portfolio status, growth, and risk	• Control of expenditures • Information on cash flows and expenditures • Information on administrative, operational, and financial self-sufficiency at month's end
Regional Level	• Control of branch portfolios • Projection of cash flows for each branch • Regional statistics	• Simple accounting • Automatic entries for portfolio, fixed assets, payroll, and supplies • Comparative reports between branches: growth and expenditure • Publication of bank balances
National Level	• National consolidation of portfolio • Elaboration of statistics on national arrears rates, growth, stratification of terms, amounts, etc. • Risk control with other MFIs • Integration with accounting, administration, operations and finance systems	• National consolidation of balances • Detailed information on movement • Integration with other systems: portfolio, administration (fixed assets, payroll, supplies), operations (statistics), and finance (budget, financial reports)

Source: Bazoberry, "The Information Systems Challenge," 21.

From 1995 to 1998, Prodem continued to develop and improve these two systems. It modified its software to incorporate new lending products, to introduce more flexible payment plans, and to respond to other changes in user requirements. The gradual implementation of these changes made them affordable by spreading costs out over time. The ongoing process was

[44] Data were validated at the moment of entry and were then sealed as a "read only" file. Certain transactions were prohibited by the system and a message was immediately sent to the supervisor of the staff person who attempted that transaction (e.g. the creation of a new loan application for a client who already had an outstanding loan).

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Managing Information

The most challenging part of
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collect, and ensuring that the data
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xchange rates; and
ent entry error and fraud.[4]
systems are summarized in Table 10.

the Excelsior and Confin Information

	Confin Accounting & Finance System
lt, and	• Control of expenditures • Information on cash flows and expenditures • Information on administrative, operational, and financial self-sufficiency at month's end
olios for	• Simple accounting • Automatic entries for portfolio, fixed assets, payroll, and supplies • Comparative reports between branches: growth and expenditure • Publication of bank balances
of on owth, MFIs ting, nt	• National consolidation of balances • Detailed information on movement • Integration with other systems: portfolio, administration (fixed assets, payroll, supplies), operations (statistics), and finance (budget, financial reports)

is Challenge," 21

inued to develop and improve these two to incorporate new lending products, to plans, and to respond to other changes in implementation of these changes made out over time. The ongoing process was

entry and were then sealed as a "read only" file he system and a message was immediately sent to mpted that transaction (e.g. the creation of a new had an outstanding loan).

made possible by the in-house presence of skilled systems staff who understood the institution, its needs, and its technology.

In 1997, when Prodem began pursuing its FFP transformation in earnest, its systems development team realized that the institution was entering another major phase of growth and would require an upgraded system to accommodate that growth. It negotiated an agreement with a local software development firm, Wiñay Pacha, to assist it in developing new software using SQL/Visual Basic technology and a Windows NT platform. After two years of development and testing, Prodem's employees were trained on the system and it was up and running by the time the FFP opened its doors. This timely implementation was possible because Prodem foresaw future technology needs and invested in their development far in advance of their demand. Prodem estimates that it cost approximately $350,000 to develop the new system. A comparable off-the-shelf product would have been much more expensive.

> *"If Prodem did not have an in-house systems team, it would have had to choose between the high costs of hiring consultants to upgrade or refine the product, or not meeting the changing needs of the users."*
>
> *– Eduardo Bazoberry*

Table 11 summarizes the comparative capabilities of the new system versus the old. In general, it is more secure, more flexible, more user-friendly and more comprehensive. It enhances Prodem's ability to organize and analyze data, and improves the speed with which all transactions are conducted. It now takes branches fifteen to twenty minutes to close their accounts at the end of the day, whereas it takes Prodem's competitors 1.5 to 2 hours to complete the same process. Three software modules have already been added to the system. In February 2000, modules were introduced for wire transfers and fixed term deposits, in September, a savings account module was introduced that incorporated the smart card technology, and in December, an updated version of the portfolio module was successfully installed. The working relationship with Wiñay Pacha has been so productive that Prodem will turn it into a permanent partnership in 2001.

Managing Information

The most challenging part of information management is not the collection and distribution of data, but rather, deciding what data to collect, and ensuring that the data are accurate, useful and distributed in a timely and cost-effective manner. The previous section described some of the improvements Prodem made to its computerized information system in an effort to increase the accuracy, usefulness and timeliness of its information processing. To conclude this chapter, some of the other strategies through which Prodem made effective use of information are discussed below.

Table 11: Comparison of Prodem's 1995 and 1999 Computerized Information Systems

Feature	1995 System	1999 System
Technology	FoxPro	SQL server with front-end Visual Basic
Platform	DOS	Windows NT
Security	Limited. Information can be lost during a power outage or when a user restarts a computer without properly exiting from the system	Data are protected against failures in the system. Can control access to data or different types of users, set passwords, and require approvals for entries that lie outside policy norms. It is possible to partition tables in the database so that concurrent users do not interfere with each other.
Analysis tools	A limited number of reports can be generated at the management level.	Computerized cash flow analysis and economic evaluation forms. Customized reporting options for managers.
Adaptability	Changing or adjusting the system is a complex and intensive process.	Database structure is very flexible. It is easy to adapt the system to add new products or alter the characteristics of existing products.
User screens	Text based system with few graphics.	Windows technology. Screens and pull down menus are very user friendly.
Compatibility	Limited importing and exporting options. Difficult to analyze data using other software programs.	Simple and immediate access to data for use with other software tools such as Excel. Data can be easily imported and exported for analysis and reporting purposes.
Functional components	Accounting, supply inventory, fixed asset register, payroll, portfolio, statistics.	Accounting, supply inventory, fixed asset register, payroll, portfolio, lines of credit, human resource management, fixed term deposits, savings accounts, wire transfers, treasury.
Y2K	Unknown how the system will react	New date format included in programming
Hardware	Supports 16 Bits	Supports 32 and 64 Bits

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Table 12: Prodem Indicators th

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8. Average loan amount disburs
9. Total amount disbursed to dat
10. Active portfolio at the end of
11. Percentage of portfolio in arre
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13. Total operational income this
14. Total staff
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	Windows technology. Screens and pull down menus are very user friendly.
d ata	Simple and immediate access to data for use with other software tools such as Excel. Data can be easily imported and exported for analysis and reporting purposes.
	Accounting, supply inventory, fixed asset register, payroll, portfolio, lines of credit, human resource management, fixed term deposits, savings accounts, wire transfers, treasury.
	New date format included in programming
	Supports 32 and 64 Bits

First, Prodem chose a limited, strategic set of indicators that it monitored regularly in order to assess institutional performance. The same set of indicators was tracked at the national, regional and branch levels. They were calculated automatically by the computerized information system and were used to evaluate the institution's current status, as well as to analyze trends.

Second, Prodem regularly examined its core performance indicators to ensure that they continued to be relevant. As the institution matured, some of its original indicators lost their usefulness, and others were added to respond to new requirements. Of the 24 original indicators, 17 continued to be monitored in 2000 and are worth noting for their permanence over time (see **Error! Not a valid bookmark self-reference**). Also interesting, however, are the changes that Prodem made, particularly to the indicators used to monitor self-sufficiency. As shown in Table 13, Prodem adopted increasingly detailed and strict criteria for measuring its sustainability. The trend reflects the sophistication with which Prodem came to understand sustainability and the extent to which it pushed itself to meet those high standards.

Table 12: Prodem Indicators that Remained Constant Over Time

1. First time borrowers this month
3. Total number of borrowers who received a loan this month
4. Percentage of borrowers who are women
5. Number of borrowers with active loans at the end of the month
6. Total number of microentrepreneurs financed to date
7. Average loan amount disbursed this month
8. Average loan amount disbursed this year
9. Total amount disbursed to date
10. Active portfolio at the end of the month
11. Percentage of portfolio in arrears at end of month
12. Amount of accumulated reserves
13. Total operational income this month
14. Total staff
15. Average portfolio per field worker
16. Average cost of disbursing one loan
17. Average cost of lending one dollar
18. Exchange rate

Third, as the number of branches grew and as the branches themselves became more diverse in age, location and size, Prodem created categories for grouping and analyzing branch information. In 1995, it began sorting branches by region and, in the following year, by branch type as well. In 1997, it expanded from three branch categories (rural, secondary cities and urban) to five in order to differentiate between large and small rural branches, and to add a category for branches that served both rural and urban areas.[illegible] This grouping of agencies into subsets made the diversity of branches more manageable. It allowed Prodem to set more targeted growth and productivity projections for each region and branch type, and facilitated comparisons between similar agencies that helped Prodem more easily identify when a particular branch was performing above or below the norm.

Table 13: Evolution of Prodem's Self-Sufficiency Indicators

Indicator	Year the Indicator is in Use												
	87	88	89	90	91	92	93	94	95	96	97	98	99
Financial costs as percentage of total expenses	X	X	X	X	X	X	X	X					
Payroll as percentage of total expenses	X	X	X	X	X	X	X	X					
% of total expenses covered by program income	X	X	X	X	X	X							
Operational self-sufficiency							X						
Operational self-sufficiency without financial costs								X					
Operational self-sufficiency with financial costs								X					
Branch self-sufficiency									X	X	X	X	X
Branch self-sufficiency with share of regional costs									X				
Branch self-sufficiency w/ regional & national costs									X				
Branch self-sufficiency w/ reg. national & financial costs									X				
Administrative self-sufficiency (branch, reg & nat costs)										X	X	X	X
Self-sufficiency w/ cost of inflation										X	X	X	X
Financial self-sufficiency w/ real cost of capital										X	X	X	X
Financial self-sufficiency w/ imputed cost of capital											X	X	X

Finally, Prodem used cost benefit analysis to help it make decisions about what information to gather and how. It recognized that information processing implied costs for both the institution and its clients and it did its

[illegible] The classification of a rural agency as large or small was based on the population of the surrounding area served by the agency.

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elf-Sufficiency Indicators

	Year the Indicator is in Use												
	87	88	89	90	91	92	93	94	95	96	97	98	99
	X	X	X	X	X	X	X	X					
	X	X	X	X	X	X	X	X					
	X	X	X	X	X	X							
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											X	X	X

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best to keep these costs down. For example, loan officers gathered a great deal of data informally while on site visits instead of requesting it on a loan application. They wrote most of their notes in client files while they were in the field and entered only select data into the computerized information system when they returned to the office. Many loan officers now use hand held computing devices such as the PalmPilot to record, organize and even compute relevant information in the field. Upon return to the office, they simply download the information into the main system.

Prodem sometimes chose not to collect information, or not to make use of a particular technology despite its availability. It has been criticized, for example, for not tracking the kind of data that would have made social impact analysis possible, and it is facing a major challenge today with respect to connectivity. Certain elements of its computerized information system do not function well in some rural areas because of the poor telecommunications infrastructure available. To employ wireless technology would cost approximately $500 per month per branch, a price that is prohibitive given the projected business volume in those areas. Thus, Prodem is unable to make maximum use of its system and customers in those areas receive a poorer quality service, which Prodem knows is risky. For now, however, that is the cost effective solution. Prodem continues to be creative with other types of technology at its disposal – smart cards, PalmPilots, cellular phones, fax machines, CB radios and even public phones as necessary to manage its information. It is also trying to develop longer term solutions that would make Internet technology more available and affordable in rural areas, through partnerships with municipalities, telecommunications companies and perhaps, because of the implications for education and training opportunities, even the Prodem Foundation.

CHAPTER 6
Product Design and Delivery

To achieve its mission, Prodem needed to provide financial services that supported microentrepreneurs' development. The tremendous effort it put into creating institutional culture, developing human resources and facilitating information flow was ultimately aimed at building an institution that could deliver products that clients considered both useful and affordable. The growth Prodem experienced from 1987 to 1998 suggests that it did, indeed, deliver effective products and this chapter will explore how it did so. After discussing the general process through which Prodem designed its offering, the chapter takes a closer look at Prodem's efforts to serve rural areas, face competition, and manage risk.

The Process

When Prodem began lending, it benefited from the work of Acción and its affiliates who had already developed a loan product that catered to the needs of microentrepreneurs in other Latin American countries. Prodem borrowed this technology and applied it so successfully that after five years it was able to create a regulated financial institution that had more clients than any other bank in Bolivia. The details of the solidarity group lending methodology have already been analyzed in great detail elsewhere and do not need to be explored again here.[31] What is interesting for the purposes of this document is Prodem's application of the group lending methodology. How did it combine this borrowed technology with Prodem's culture, structure and human resources to produce a solidarity group loan product that was commercially viable on a massive scale?

Prodem employed four strategies in the consolidation of its group lending methodology that came to define its product development process.

[31] See Maria Otero, *Solidarity Group Concept*; or Shari Berenbach and Diego Guzman, "The Solidarity Group Experience Worldwide," in Otero and Rhyne, *The New World of Microenterprise Finance*.

First, it made product development
participatory. It never tasked ar
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This participatory approach was
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"Whatever we do outside, we also have to do inside."

– Pancho Otero

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First, it made product development highly participatory. It never tasked any one department with the full-time research, testing and adaptation of products. Rather, it solicited ideas for product development from everyone in the institution and it developed those ideas through ad hoc teams that included clients, field officers, management, information systems staff and technical specialists.

"In other organizations, one group thinks and another group does. It's not like that at Prodem."

- Jose Herrera

This participatory approach was aided by Prodem's early investments in building trust-based relationships among its staff and its clients, providing employees with annual training in listening and communication skills, and nurturing dynamic feedback loops. Ideas flowed from clients to loan officers to local managers and to national managers as a normal part of Prodem's everyday activities. Technical staff became involved in the product development process as new ideas were explored, but they never took control or ownership of it. Management, field staff and clients continued to be involved; they were the ones who tested the prototypes of new ideas.

The involvement of so many different actors in the product development process generated a diversity of ideas, expertise and perspectives that enriched the quality and effectiveness of product design. The participatory process also enabled the rapid and effective implementation of new design elements since all sectors of the institution were involved in the design, generally understood the purpose of the changes, and were committed to their application.

"Whatever we do outside, we also have to do inside."

– Pancho Otero

Prodem's second strategy was to seek coherence between what it promoted outside and inside the institution. For example, it offered a loan product that expected clients to support each other in teams, and it organized its staff to deliver that product while working in teams. It structured the loan approval process so that decisions were made by a credit committee, and not by any one loan officer or manager. Because staff knew what it meant to work as a team, and because they knew how difficult it was at times to create a supportive team, they were better able to relate to their clients' experiences and could more effectively support team-building among their clients.

> *"There was consistency between the personalized culture, based on trust, teamwork and peer monitoring among employees, and its personalized lending technology, based on trust in the client and peer monitoring among borrowers in the group."*
>
> - Claudio Gonzalez-Vega, et al.[30]

In a similar manner, Prodem encouraged both clients and staff to pursue excellence. Loan officers were motivated through training seminars and through the examples set by the institution's management. The loan officers, in turn, motivated their clients. They understood the pride and self-esteem that resulted from a job well done and they were keen to help their clients experience similar satisfaction. They believed that if a client accepted responsibility for a loan and was able to repay it on time while supporting others to do the same, he or she would gain confidence in addition to an excellent credit history. The pursuit of excellence became a tool for institutional and personal development.

Prodem's third strategy was to pay attention to both client and institutional needs. Prodem recognized that to provide clients with a valuable service over the long term, it needed to maintain a strong institution. It had to design products that would be useful to clients and could be delivered affordably by the institution. Developing a product that fulfilled only one or the other of these goals would be counter-productive.

Prodem's attentiveness to its institutional needs and not just its clients' needs was not automatic; it was the result of a concerted and sustained effort. Although Acción espoused the policy and Otero understood its importance, bringing all of Prodem's employees together on the issue was a slow and sometimes difficult undertaking. It was made possible only by the participatory nature of the product development process and the institution's policy of collective decision-making (see Box 2). Even among board members, consensus on this issue was difficult to achieve. The decision to charge poor microentrepreneurs a market rate of interest, for example, was extremely contentious.[31] Ultimately, the mix of backgrounds represented on the board enabled members to resolve the conflict between meeting client needs and institutional needs and adopt a balanced approach.

[30] Claudio Gonzalez-Vega, et al., "BancoSol: The Challenge of Growth for Microfinance Organizations," Occasional Paper No. 2332 (Columbus, Ohio: Ohio State University Economics and Sociology Department, August 1996) 25.

[31] "Market rate of interest" is defined here as the rate of interest that needed to be charged in order to cover the cost of making loans.

Box 2: Policy Ma

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Box 2: Policy Making by Committee

From the day Prodem began lending until 1999, the vast majority of its loans were approved by credit committees and not by individuals. Each branch had its own committee, which consisted of all the loan officers in the branch. Although the branch manager often sat in on the committee's meetings, he/she was not an active participant.

Through the credit committee, many of Prodem's core cultural tenets were put into practice. The committee fostered teamwork, facilitated horizontal management and encouraged participation. A president facilitated the meetings and a secretary took minutes. These two positions rotated among the loan officers every three months. Decisions were made primarily by consensus and were recorded in the minutes, a practice which provided institutional memory and accountability.

Although the purpose of the credit committee was to discuss who should and should not receive a loan, policy issues were inevitably raised in the committee's meetings. Specific loan requests led the committee to discuss general issues concerning the application of the solidarity group lending methodology. To decide whether or not to approve a loan request, the committee had to decide where it stood on the issue in question. By taking a stand, it set institutional policy. For example, at one committee meeting a loan officer presented an application from a group in which two members belonged to the same family. Another loan officer objected to the application because in the past she had had nothing but trouble from groups that contained family members. This discussion ultimately led to a policy preventing relatives from being members of the same solidarity group.

The credit committee mechanism also provided a forum for discussing and resolving broader policy issues. Loan officers frequently identified clients who they felt would benefit from some kind of training, so the question was often raised, "should Prodem provide training for its clients?" It was in the credit committee that consensus was established in support of a minimalist approach to lending.

Pancho Otero argues that it was this participatory way of making policy decisions that enabled Prodem to apply the solidarity group loan methodology so successfully. He describes one of Prodem's defining moments as the meeting in which loan officers debated whether or not to forgive the loan of a female client who had fallen on very hard times. One side felt that it was wrong to make the client repay since Prodem's ultimate purpose was to support microentrepreneurs' development, not to contribute to their impoverishment. The other side felt that Prodem had to insist on repayment in one way or another because if it did not, it would send a signal to all clients that loans did not have to be repaid. At the first sign of trouble, borrowers would default, Prodem would quickly go bankrupt and find itself unable to support anyone's development.

The credit committee's decision not to forgive the woman's loan was a critical moment for Prodem. It was arrived at only after much discussion and debate, but since it was decided by consensus there was a general understanding of the policy and a commitment to its implementation that could not have been achieved by any one manager making the decision on his own.

Interestingly, when Prodem decided to implement stricter standards of individual accountability in early 1999, it eliminated the process of approving loans by committee, yet it retained the committee mechanism. Loan officers continue to meet once a week to discuss their portfolios, share concerns, solve problems, etc. but they do so as a feedback committee rather than as a credit committee.

Sol: The Challenge of Growth for Microfinance
2332 (Columbus, Ohio: Ohio State University,
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s.

The fourth strategy employed by Prodem was that of constant improvement. Prodem did not see product development as a defined or bounded process with a beginning and end. Rather, product development was a never-ending process of improving the institution's service to its clients, responding to their changing needs, and adapting to an ever-changing external environment. Prodem continuously sought and analyzed feedback, tested new ideas, and put mechanisms in place to monitor changes and to assess the implications of those changes for the institution. Together with the other three strategies mentioned above, this approach kept Prodem's product development process from becoming static and, indeed, enabled the institution to become and to remain in the vanguard of a very rapidly developing market.

> *"Two things set apart all organizations with a good record of innovation. One is that they foster individuals who are internally driven. The second is that they do not leave innovation to chance: they pursue it systematically."*
>
> *- The Economist, February 20, 1999*

Serving Rural Areas

Prodem applied all four strategies to consolidate a solidarity group loan product that was effective in an urban Bolivian context. Because of its success, Prodem used the same process to develop a loan product that could effectively serve rural areas. This time, however, it dared to make more serious modifications to its borrowed technology. Its experience with the solidarity group loan methodology and its accumulating knowledge of the market gave Prodem the confidence, tools and impetus to experiment more boldly. Such experimentation was necessary given the radically different environment Prodem faced in the rural areas. Among other factors, the low population density, lack of physical infrastructure, scarce resources and limited communications technology challenged Prodem's ability to reach rural microentrepreneurs in a sustainable manner.

A More Flexible Product

When Prodem moved into rural areas, it began lending with the same methodology it had used in urban areas. It offered a joint-liability loan repayable in regular, equal installments. It evaluated loan requests by examining the household cash flow of potential borrowers to ensure that they had the ability to repay the loan being requested.

"Two things set apart all organizations with a good record of innovation. One is that they foster individuals who are internally driven. The second is that they do not leave innovation to chance: they pursue it systematically."

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s to consolidate a solidarity group loan rban Bolivian context. Because of its ss to develop a loan product that could time, however, it dared to make more d technology. Its experience with the and its accumulating knowledge of the , tools and impetus to experiment more necessary given the radically different rural areas. Among other factors, the ical infrastructure, scarce resources and y challenged Prodem's ability to reach nable manner.

areas, it began lending with the same areas. It offered a joint-liability loan ments. It evaluated loan requests by of potential borrowers to ensure that an being requested.

By focusing on household cash flow, Prodem introduced the first innovative element of its rural lending methodology. Rather than enter rural areas with a focus on agricultural lending, it entered with a focus on lending to microentrepreneurs. It considered both farm and off-farm income sources when examining the cash flow of a potential borrower.

This was an interesting, but problematic innovation. Since 90 percent of Bolivia's rural population worked in the informal sector, and since much of their work was agriculture-based, monthly cash flows varied greatly with the timing and quality of harvests. Borrowers needed a loan product that was not only authorized on the basis of cash flow, but was also scheduled on the basis of cash flow. The product Prodem initially marketed did not allow this flexibility.

Differentiated Payment Plan

After spending several months collecting information on its clients' activities and cash flows, getting to know local crop cycles and the experiences of neighborhood moneylenders, staff at Prodem's Caranavi branch proposed to national management a loan product with repayment terms that would allow borrowers to service their loans in a manner that was appropriate for their cash flow. Instead of making equal monthly payments, groups could customize the size of each month's payment to concentrate payments of principal in those months when the group generated greater income. Payments would still be made monthly, but the amount and composition of each month's payment would vary. In some months, interest only would be paid and in others, capital with interest. Table 14 provides an example of such a repayment schedule for a coffee producer in Caranavi.

Table 14: Differentiated Payment Plan for a Coffee Producer with a $2,131 Loan

Month	1	2	3	4	5	6	7	8
Coffee Harvest					XXX	XXX	XXX	
Principal Payment					783	783	783	783
Interest Payment (2.5% per month nominal)	117	117	117	117	117	88	58	29
Total Payment	117	117	117	117	900	871	841	812

Source: Lee, "Client-Based Market Research," 12.

Management scrutinized Caranavi's proposal carefully, in particular because the recently failed State Agricultural Bank had used a similar methodology and it had proven ineffective. Caranavi staff argued that it was not the methodology, but the manner in which the methodology was implemented that had led to the bank's failure. They collected data from their clients supporting this argument and demonstrating why rural borrowers needed a payment plan that was more flexible than the one Prodem currently offered.

Their data ultimately persuaded Prodem's management to approve a pilot testing of the differentiated payment plan, or "quotas diferenciales" as it came to be known within Prodem. Recognizing the payment problems that could result from concentrating the payment of capital at the end of a loan, Prodem placed a limit on the maximum percentage of principal that could be payable in a single installment. Initially set at 60 percent, this amount was subsequently lowered to 40 percent.

After a year of experimentation with differentiated quotas, Caranavi's active loan portfolio grew 36 percent compared with the 29 percent average portfolio growth of all other rural branches that were operating by the beginning of 1994. It achieved this level of growth while maintaining a 30-day portfolio at risk below 0.3 percent. As a result of this success, Prodem introduced the differentiated quota technology to other branches and, by 1997, all 22 rural agencies had implemented the design.[34]

Personalized Payment Plan

Despite the successful implementation of the differentiated payment plan, Prodem's rural clients continued to press for more flexibility and staff sought ways to accommodate that request. They recognized that the new payment plan had a fundamental weakness: it assumed that the members of each solidarity group were involved in the same productive activities. It did not allow for differences in cash flow needs among households with similar productive activities, much less among producers with different crop harvests. As such, it made it difficult to negotiate a payment plan that was equally sensible and convenient for all members of the group. Unless the group was extremely homogenous, some members had difficulty making the large payments required in certain months because their household's cash flow did not

> *"The personalized payment plan provided the advantages of group liability with the flexibility of individual repayment terms."*
>
> *– Nanci Lee*

[34] Lee, Nanci, "Client-Based Market Research: The Case of Prodem" (Toronto: Calmeadow, 2000) 14.

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highly homogeneous presented Prod
of total default. Should the commo
disease, everyone in the group woul
strong enough position to help the

Prodem saw room to improv
personalized payment plan know
demonstrated in Table 15, this pay
group to design a personal repaym
household's cash flow. Members stil
the size of the payment varied from
individual's portion of the paymen
Each payment had to include a port
payment could equal more than 40

The personalized payment plan w
most established rural agencies, and
effective because it provided
simultaneously lowering risk for the

Table 15: Sample Schedule for a
Personalized Payment Plan

	G			
Group Repayment Date	Rafael coffee farmer / tire sales Loan = $US 474			
	Payment	Interest	Total	Paym
Aug 21	9	18	27	1
July 18	9	17	26	1
Oct 16	19	17	36	9
Nov 13	9	16	25	1
Dec 12	95	16	111	1
Jan 8	95	12	107	9
Feb 5	95	9	104	9
March 5	95	5	100	6
April 3	19	2	21	6
May 3	19	1	20	7
May 28	10	1	11	7
TOTAL	474	114	588	4

Source: Lee, "Client-Based Market Research

neffective. Caranavi staff argued that it
manner in which the methodology was
bank's failure. They collected data from
gument and demonstrating why rural
n that was more flexible than the one

ed Prodem's management to approve a
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group. Unless the group was extremely
difficulty making the large payments
se their household's cash flow did not

ch: The Case of Prodem" (Toronto: Calmeadow,

match the group's cash flow. At the same time, those groups that were highly homogeneous presented Prodem with a different kind of risk—that of total default. Should the common crop be destroyed by bad weather or disease, everyone in the group would suffer and no one would remain in a strong enough position to help the others out.

Prodem saw room to improve the methodology and designed a personalized payment plan known as "quotas personalizadas". As demonstrated in Table 15, this payment plan allowed each member of a group to design a personal repayment schedule that matched his or her household's cash flow. Members still made regular payments as a group, but the size of the payment varied from month to month, as did the size of each individual's portion of the payment. There were only two restrictions. Each payment had to include a portion of capital and interest, and no one payment could equal more than 40 percent of the original loan amount.

The personalized payment plan was introduced in 1996, first at Prodem's most established rural agencies, and later nationwide. The product proved effective because it provided greater flexibility for clients while simultaneously lowering risk for the institution.

Table 15: Sample Schedule for a 3-Person Group Using the Personalized Payment Plan

	Group Member Payments								
Group Repayment Date	Rafael coffee farmer / tire sales Loan = $US 474			Miguel coffee farmer / carpentry Loan = $US 474			Jorge coffee farmer Loan = $US 474		
	Payment	Interest	Total	Payment	Interest	Total	Payment	Interest	Total
Aug 21	9	18	27	19	18	37	19	18	37
July 18	9	17	26	19	17	36	19	17	36
Oct 16	19	17	36	95	16	111	19	16	35
Nov 13	9	16	25	19	13	32	19	16	35
Dec 12	95	16	111	19	12	31	19	15	34
Jan 8	95	12	107	9	11	20	19	14	33
Feb 5	95	9	104	9	11	16	19	13	32
March 5	95	5	100	66	11	77	19	13	32
April 3	19	2	21	66	8	74	95	12	107
May 3	19	1	20	76	6	82	95	8	103
May 28	10	1	11	76	4	80	132	6	138
TOTAL	474	114	588	474	127	596	474	148	622

Source: Lee, *"Client-Based Market Research,"* 13.

Although Prodem initially thought that tailored repayment schedules would be appropriate only for farmers, it soon realized that the new payment terms were useful for rural clients in the commercial sector as well. Table 16 illustrates that the cash flow of a rural grocery vendor fluctuates in much the same way as that of a farmer, precisely because farmers are her clients and their purchases (and their ability to pay for purchases) vary with their income flow. During March, April and May, the vendor's sales are almost twice as high as her sales in January and February because farmers are harvesting soya and rice and they have additional income to spend in her store. By contrast, in July and August, when nothing is being harvested, the vendor not only sells fewer goods, but she offers credit to clients whose cash flow is frozen until September. Her credit needs and ability to pay may fluctuate even more wildly than those of the farmers who buy her goods.

Table 16: Cash Flow Analysis for a Grocery Vendor

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Soya Harvest				■	■				■	■		
Rice Harvest			■	■								
Cane Harvest									■	■		
Credit to Clients							■	■				■
Sales/Week	1423	1423	2846	2846	2846	1423	1314	1314	2846	2846	2846	2846
Purchases/Week	949	949	1898	1898	1898	1898	949	949	1898	1898	1898	1898
Net Income	474	474	948	948	948	-475	365	365	948	948	948	948

Source: Lee, "Client-Based Market Research," 14.

Making it Affordable

In serving rural areas, the second half of Prodem's challenge was to develop a loan product that could generate sufficient revenue to cover the costs of lending. This was no easy task in an environment with much poorer infrastructure, scarcer resources and fewer economies of scale than had been present in urban areas. Although the differentiated and personalized payment plans made Prodem's solidarity group product more attractive to rural borrowers, their implementation was more time consuming and complex than the standardized repayment methodology. If anything, they increased the cost of lending rather than decreased it. How, then, were rural branches in communities such as Caranavi, Minero, Sacaba and Punata able to fully cover their costs, including their share of national level expenses, by the end of 1995? The "secret" lies in Prodem's product delivery.

Standardization vs. Flexibility

By 1992, microfinance best prac
microcredit operations require sta
Prodem itself had demonstrated this
operationally self-sufficient lending ins
and more than 22,000 clients by off
clients started out with a small loan,
through sequential borrowing and on
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were made in regular, equal installmen

Prodem knew that standardization
also knew that its loan product had to
rural areas. While standardization
exclusive, Prodem found ways of i
delivery. It introduced a personalize
much more flexibility in the schedul
and automated the implementation
made it affordable.

Figuring out how to incorporate
information system was an integra
process. Fortunately, Prodem had
solution quickly. Its systems speciali
officers and management to ensure
entered into the system, analyzed, ap
the new payment plans were unde
governed their application could be i
options and default values that app
streamlining their implementation.
help clients keep track of the fluctua
information contained in this bookl
new software and printed on a one-
could be folded in three and easily ca

In addition, a computerized cash
available to loan officers when the
The program allowed loan officers
yields, sale prices and costs per hecta
only to provide information on the
the number of hectares of each, and
(see Table 17). Of course, home of
and loan officers required additiona

Standardization vs. Flexibility

By 1992, microfinance best practice had established that efficient microcredit operations require standardized lending methodologies. Prodem itself had demonstrated this in its urban operations. It built an operationally self-sufficient lending institution with a $4.6 million portfolio and more than 22,000 clients by offering one standardized product. All clients started out with a small loan, the size of which could be increased through sequential borrowing and on-time repayment. Everyone paid the same interest rate and the same administrative fee, and everyone's payments were made in regular, equal installments.

Prodem knew that standardization facilitated efficiency, but by 1993, it also knew that its loan product had to be flexible if it was to be effective in rural areas. While standardization and flexibility may seem mutually exclusive, Prodem found ways of incorporating both into its product delivery. It introduced a personalized payment plan that gave borrowers much more flexibility in the scheduling of their loans, yet it standardized and automated the implementation of that payment plan, which is what made it affordable.

Figuring out how to incorporate the new payment plan into Prodem's information system was an integral part of the product development process. Fortunately, Prodem had the in-house expertise to design a solution quickly. Its systems specialists worked with operations staff, field officers and management to ensure that the new loans could be easily entered into the system, analyzed, approved and monitored. Even though the new payment plans were undeniably more complex, the rules that governed their application could be incorporated into the loan forms, menu options and default values that appeared on the computer screen, thus streamlining their implementation. New credit booklets were designed to help clients keep track of the fluctuating monthly payment amounts. The information contained in this booklet was processed automatically by the new software and printed on a one-page sheet of heavy weight paper that could be folded in three and easily carried in a pocket.

In addition, a computerized cash flow tool was developed and made available to loan officers when the new payment plans were introduced. The program allowed loan officers to enter baseline data on local crop yields, sale prices and costs per hectare. A potential borrower then needed only to provide information on the types of crops he or she produced and the number of hectares of each, and the software computed the cash flow (see Table 17). Of course, home office staff had to develop these systems and loan officers required additional training in economic evaluation and cash flow analysis to use them effectively, but these investments paid for themselves because they resulted in a product design that attracted more borrowers, increased client retention, and facilitated repayment.

Table 17: Sample Print Out of Prodem's Cash Flow Program - Soya Farmer

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Income												
Beans (2 Ha.)									3600			
Rice (5 Ha.)										2204		
Soya (2.5 Ha.)				3307						800	800	800
Other Income	800	800	800	800	800	800	800	800	800			
Total	800	800	800	4107	800	800	800	800	4400	3004	800	800
Expenses												
Food	520	520	520	520	520	520	520	520	520	520	520	520
Services	30	30	30	30	30	30	30	30	30	30	30	30
Activities:												
Beans					706	247	247	247	556			
Rice	168	168	442								657	168
Soya						708	200	200	205	527		
Total	718	718	992	550	1256	1505	997	997	1311	1077	1207	718
Monthly Balance	82	82	192	3557	456	705	197	197	3089	1927	407	82
Accumulated Balance	82	164	28	3529	3073	2368	2171	1974	5063	6990	6583	[illegible]

Source: Lee, "Client-Based," March 1999 draft, 17.

Although the payment plan example illustrates one of the ways in which Prodem balanced standardization with flexibility, there are many other examples. For instance, Prodem designed a standard set of flip charts to facilitate the orientation sessions for new borrowers in all of its branches. The flip charts made the process of delivering orientations more efficient and they provided a common standard and a certain amount of quality control over the content of the presentations. What made the flip charts particularly useful, however, was their built-in flexibility. The charts used pictures and numbers rather than words, so they could be used to explain Prodem's products and concepts in any language. This was important given the mix of languages spoken in rural areas and the fact that roughly one-third of the rural population is illiterate.55 In addition, each page of the

55 The rural illiteracy rate was 36 percent in 1992 according to the 1994 UNESCO statistical yearbook. It is cited in "The Expansion and Distribution of Latin American Education," a paper written by Ana María Eichelbaum de Babini, a former professor of sociology of education the University of Buenos Aires and researcher of the National Council of Scientific and Technical Research of the Center for Research in Educational Sciences of the Torcuato Di Tella Institute.

flip chart was covered with plastic so t
emphasize certain points or include
local circumstances. At the end of
could be wiped off.

Prodem did not "discover" th
microfinance; it simply reaffirmed the
notion that microfinance, in addition
simple if it was to be cost-effective. I
necessarily so.

Expansion

In its urban lending operations, Pr
of scale with a small number of branc
the creation of BancoSol, its four bra
each and were generating enough rev
operational expenses. The average br
than $1 million.

Table 18: Average Outstanding Port
= US$)

	1991	199
Total Outstanding		
Portfolio	4,561,775	2,177,
Number of Branches	4	7
Portfolio per Branch	1,140,443	311,0

Source: Prodem Monthly Program Indicators

Given Bolivia's low rural populatio
capturing such a large market with
come up with another way to achiev
was geographic expansion. Prodem
strategy that involved opening a large
as possible. In 1992 it opened six ne
more. Between 1994 and 1998, it
Table 18 shows that this strategy ena
portfolio in rural areas by 1995 as it h
of 1991.

fectively, but these investments paid for in a product design that attracted more on, and facilitated repayment.

rodem's Cash Flow Program - Soya

May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
				3600			
					2204		
					800	800	800
800	800	800	800	800			
800	800	800	800	4400	3004	800	800
520	520	520	520	520	520	520	520
30	30	30	30	30	30	30	30
706	247	247	247	556			
						657	168
	708	200	200	205	527		
1256	1505	997	997	1311	1077	1207	718
456	705	197	197	3089	1927	407	82
3073	2368	2171	1974	5063	6990	6583	6665

aft, 17.

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flip chart was covered with plastic so that the presenter could write on it to emphasize certain points or include additional detail as necessary given local circumstances. At the end of the presentation, those added notes could be wiped off.

Prodem did not "discover" the benefits of standardization for microfinance; it simply reaffirmed them. What Prodem discarded was the notion that microfinance, in addition to being standardized, also had to be simple if it was to be cost-effective. Prodem demonstrated that this is not necessarily so.

Expansion

In its urban lending operations, Prodem achieved significant economies of scale with a small number of branches. By the end of 1991, just before the creation of BancoSol, its four branches had an average of 5,686 clients each and were generating enough revenue to cover all of the institution's operational expenses. The average branch outstanding portfolio was more than $1 million.

Table 18: Average Outstanding Portfolio per Branch (at year end in US$)

	1991	1992	1993	1994	1995
Total Outstanding Portfolio	4,561,775	2,177,655	3,660,337	2,597,031	4,516,523
Number of Branches	4	7	11	18	27
Portfolio per Branch	1,140,443	311,094	332,758	144,280	167,279

Source: Prodem Monthly Program Indicators

Given Bolivia's low rural population density, Prodem could not dream of capturing such a large market with each of its rural branches. It had to come up with another way to achieve economies of scale, and its solution was geographic expansion. Prodem embarked on an aggressive growth strategy that involved opening a large number of small branches as quickly as possible. In 1992 it opened six new branches. In 1993, it opened five more. Between 1994 and 1998, it opened a total of 44 new branches. Table 18 shows that this strategy enabled Prodem to achieve the same size portfolio in rural areas by 1995 as it had achieved in urban areas by the end of 1991.

To Spend or Not to Spend

One of Prodem's operational strategies when entering rural areas was to keep fixed costs as low as possible. It rented office space rather than buying property. It bought basic, sometimes second-hand office equipment and supplies. It minimized the number of staff working in each branch and asked all employees to share the tasks that needed to be carried out on any given day. It also did its best to keep variable costs in check, particularly those created by delinquent borrowers. This cost control strategy was a logical one and it did generate efficiencies, but nothing out of the ordinary.

The more interesting elements of Prodem's cost-cutting strategy were those that required the institution to spend more money, not less. Prodem increased the amount of money it spent on desktop computers and servers, on motorcycles and automobiles, and on Internet access, fax machines and cellular phones. It may seem counter-intuitive, but these investments increased Prodem's efficiency to a degree that far outweighed their cost.

The example of increasing expenditures on motorcycles is perhaps the most illustrative. In sparsely populated Bolivia, a round trip visit to a client on foot or by public transport could easily take three hours. With a motorcycle, that same loan officer could visit the client and be back at the office (or with another client) in less than an hour, effectively increasing his productivity by 300 percent. With that kind of return on investment, the price of the motorcycle was paid for in no time.

Prodem made other, more extensive investments that were described in detail above, most notably those in technology and staff training. Prodem's cultural seminars, for example, rallied staff behind the institution's mission and vision. Loan officers truly believed in what Prodem was trying to do and were keen to contribute something valuable to that effort. They worked very hard and put in extra hours if necessary to deliver the quality of service they felt Prodem should be delivering. At the same time, Prodem's investment in telecommunications and computer technology made the process of delivering high quality service increasingly viable. It reduced the cost, time and energy spent moving information from place to place. Instead of hand-carrying information on a floppy disk to the nearest regional office, Prodem branches could fax, email, telephone or radio information to multiple locations in a fraction of the time.

When motivated loan officers were armed with additional training and improved technology, they were noticeably more productive. As shown in Table 19, the average loan balance at the end of 1993—the year Prodem began focusing on rural areas—was the same as that of 1996. Yet, by the end of 1996, the average loan officer was managing a 33 percent larger portfolio and 34 percent more clients than he had been three years earlier.

That increase in productivity help
the same period.

Table 19: Efficiency Indicators 19

Indicator
Average loan balance (in US$)
Loan portfolio per loan officer (in '000s)
Number of active borrowers per loan office
Cost per unit of money lent (average for ye
Operating expense ratio (%)

Source: Prodem Monthly Program Indicators

Facing Competition

From 1993 to 1995, Prodem was fre
developing a sustainable solidarity
made significant progress towards
serving more than 18,000 clients a
percent financially self-sufficient.
significant competition began to ap
even before it had fully met its origi
the competitive pressure are explor

Pricing

In its early years, Prodem experienc
that it was not too concerned abou
interest rates at the level ne
sustainability.[36] As competitio
organizations began to offer borro
pricing became an issue.

Prodem responded to the pressur
it classified branches into five cate
competition in the area as well as
scheduled interest rates and commi
with the lowest rates being charge
competition. In these branches,
interest rates on US dollar loans ra

[36] Although prices were set at a rate tha
considerable pressure on Prodem both inter
There was considerable concern that by ch
be open to attack politically. Otero ultimat
"the poor are not sensitive to interest rates

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were armed with additional training and oticeably more productive. As shown in e at the end of 1993—the year Prodem s the same as that of 1996. Yet, by the ficer was managing a 33 percent larger nts than he had been three years earlier.

That increase in productivity helped fuel Prodem's efficiency gains during the same period.

Table 19: Efficiency Indicators 1993-1996 (as of Dec 31)

Indicator	1993	1994	1995	1996
Average loan balance (in US$)	300	260	247	301
Loan portfolio per loan officer (in '000s)	60	46	56	80
Number of active borrowers per loan officer	200	175	226	267
Cost per unit of money lent (average for year)	0.16	0.17	0.18	0.12
Operating expense ratio (%)	27	21	20	20

Source: *Prodem Monthly Program Indicators*

Facing Competition

From 1993 to 1995, Prodem was free to focus its attention and resources on developing a sustainable solidarity group loan product for rural areas. It made significant progress towards this goal by the end of 1995. It was serving more than 18,000 clients and its network of 27 branches was 92 percent financially self-sufficient. During the following year, however, significant competition began to appear and Prodem faced new challenges even before it had fully met its original goal. Some of the ways it dealt with the competitive pressure are explored below.

Pricing

In its early years, Prodem experienced such a high demand for its services that it was not too concerned about the effect of price on demand. It set interest rates at the level necessary to ensure the institution's sustainability.* As competition increased, however, and other organizations began to offer borrowers similar products at a lower rate, pricing became an issue.

Prodem responded to the pressure, in part, by lowering prices. In 1997, it classified branches into five categories taking into account the level of competition in the area as well as the cost of providing services. It then scheduled interest rates and commission fees to vary across the categories, with the lowest rates being charged by the branches facing the toughest competition. In these branches, no commission fee was charged and interest rates on US dollar loans ranged from 2 to 3 percent depending on

* Although prices were set at a rate that was high enough to cover costs, there was considerable pressure on Prodem both internally and externally to set rates at a lower level. There was considerable concern that by charging higher rates, Prodem's leadership would be open to attack politically. Otero ultimately persuaded the board with the argument that "the poor are not sensitive to interest rates; they are sensitive to good service."

the loan size. In all branches, loans made in dollars had a lower interest rate and commission fee than those made in the national currency in recognition of the exchange rate risk that clients were expected to assume. (See Table 20 for an example of the price schedule for one of the five branch categories.)

Table 20: Pricing Schedule for Prodem Branches in "Category 3"

Loan Amount	In Bolivianos (Bs.) Interest (%)	Commission (%)	In US$ Interest (%)	Commission (%)
Up to $750 or the equivalent in Bs.	4.0	2.5	3.5	2.0
Between $751 and 1,500 or the equivalent in Bs.	4.0	1.0	3.5	1.0
Between $1,501 and 5,000	N/A	N/A	3.5	0
Between $5,001 and 10,000	N/A	N/A	3.0	0
Between $10,001 and 30,000	N/A	N/A	2.5	0

Source: Prodem

Prodem's pricing strategy was an innovative response to immediate competitive pressures, but it was also a short-term response. The changes described above resulted in a 25 percent decrease in Prodem's revenue and a significant reduction in profits. To have continued on that price-reduction path before generating additional operational efficiencies would have meant lowering prices below the level of costs, an option Prodem knew was unsustainable. Thus, it chose to pursue opportunities that focused on creating new value for itself and its clients, rather than trying to capture additional business in already saturated markets. It continued to lower prices over time and by 2000 had both eliminated its fees and lowered its average interest rate to 32.5 percent per annum, but its real priority in the years to come was to differentiate its service through the development of new products and technology.

Product Diversification

After ten years of relying solely on its solidarity group product, Prodem finally introduced an individual loan product in October 1997. The product was developed and tested for several years before hitting the market suddenly. The imminent entry of an individual lending competitor prompted one branch to argue convincingly for the immediate implementation of the individual loan product so the branch could pre-empt an almost certain loss of market share. All of Prodem's branches were invited to implement the individual loan product simultaneously, but in

practice, each agency implemented it
of 1998, individual loans accounted
portfolio and 7 percent of it borrower

Technically, the individual loan w
served a different market than Prodem
had real collateral to offer as a guara
solidarity group borrowers and made
larger loan amounts for longer paymen
institutional efficiency. The indivi
riskier because it lacked the group scr
mechanism that had proven so useful
Prodem compensated for this throu
process.

In 1998, Prodem enhanced the in
into a line of credit. This lowered tr
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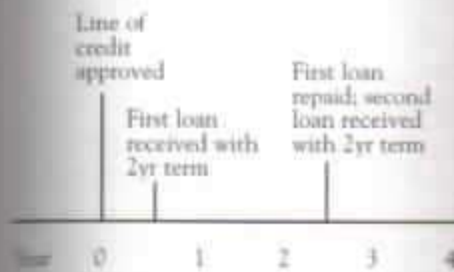
Figure 18 : Sample Line of Credit L



ns made in dollars had a lower interest
ose made in the national currency in
sk that clients were expected to assume.
the price schedule for one of the five

rodem Branches in "Category 3"

In Bolivianos (Bs.)		In US$	
terest (%)	Commission (%)	Interest (%)	Commission (%)
4.0	2.5	3.5	2.0
4.0	1.0	3.5	1.0
N/A	N/A	3.5	0
N/A	N/A	3.0	0
N/A	N/A	2.5	0

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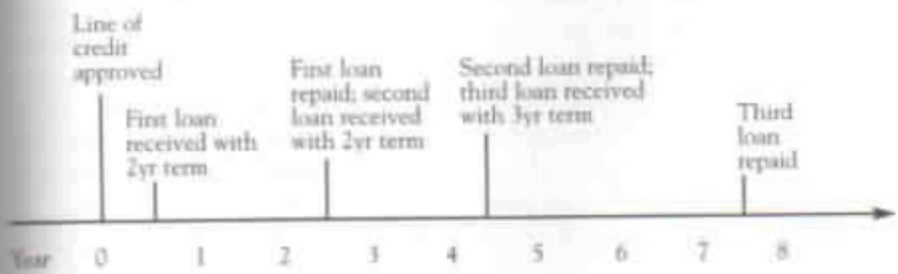
rket share. All of Prodem's branches were
idual loan product simultaneously, but in

practice, each agency implemented it based on local demand. At the end of 1998, individual loans accounted for 28 percent of the institution's portfolio and 7 percent of it borrowers.

Technically, the individual loan was fairly easy to implement because it served a different market than Prodem's first product. Individual borrowers had real collateral to offer as a guarantee, which distinguished them from solidarity group borrowers and made it possible for the institution to offer larger loan amounts for longer payment periods. This, in turn, improved its institutional efficiency. The individual loan was generally considered riskier because it lacked the group screening, monitoring, and enforcement mechanism that had proven so useful in the solidarity group product, but Prodem compensated for this through a rigorous economic evaluation process.

In 1998, Prodem enhanced the individual loan product by turning it into a line of credit. This lowered transaction costs for both Prodem and its borrowers by requiring only one application for a pre-authorized amount of funds during a five-year period. Having obtained a line of credit, the borrower could decide when he or she wanted to receive the funds and would not pay interest on the loan until it was actually disbursed. Each loan on the line of credit could have a maximum term of three years and a maximum amount of $30,000. The loan amount was determined by an economic evaluation and by the commercial value of the guarantee registered during the line of credit application process. Internal policy allowed loans to be made for up to two-thirds of the collateral guarantee. Loans within the line of credit could be renewed twice on the basis of subsequent economic evaluations, theoretically providing a client with access to funds over an eight-year period with very low transaction costs (see Figure 18).

Figure 18 : Sample Line of Credit Life Cycle



The introduction of an individual loan product was an important move for Prodem, but it was still largely a reactive rather than a proactive step. Prodem's diversification process became much more interesting as its FFP application moved along and the institution began to define a competitive strategy for the future. That strategy had two foci. First, Prodem would develop a network of branches that would have more breadth than any other financial institution in the country. Prodem would go to places where no one else could go (or perhaps, where no one else wanted to go), and it would link those places together with regional and national commercial centers. Second, Prodem would develop a package of financial services that would meet a variety of client needs and not just credit. It was believed that this package of services, and not any one product, was what would ultimately make Prodem attractive in comparison with its competitors.

Between 1995 and 1998, Prodem partnered with Calmeadow to carry out a substantial research initiative designed to assess the impact and role of Prodem's credit services in rural households and markets. Researchers used household surveys and focus groups to gather information about clients' financial needs, savings patterns and market position, as well as to test ideas for new products. In 1995, and again in 1997, subsector analyses were carried out in an effort to map the dynamic relationships between clients, their buyers, their suppliers, and their intermediaries, as well as the financial services and commercialization channels available to them. The analyses helped Prodem identify sources of client satisfaction and dissatisfaction, design strategies for more effective intervention, and perhaps most importantly, identify opportunities for new product development in the areas of savings, leasing and wire transfers.[37]

"There's no loyalty for a single product."

– Eduardo Bazoberry

Prodem was aggressive in the development of its wire transfer product, knowing that its network of 50+ branches in urban and rural areas throughout the country provided it with a unique opportunity to capture market share in this new service area. Transfers promised to be a profitable activity with a low level of risk and a high demand. Family members in urban areas wanted to remit funds to family members in rural areas. A microentrepreneur who sold goods in one town could send his revenues to the town where he lived rather than risk carrying large quantities of cash with him on his return. The government would no doubt be interested in

[37] See Lee, "Client-Based Market Research" for more detail on this process.

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wiring rural teachers' salaries to a Prodem branch near their place of work rather than giving them two days off to come and collect it in urban areas. The list of potential users and uses went on and on.

Prodem pushed its domestic wire transfer product out the door in early 1999 and negotiated an agreement with Western Union later in the year to provide international wire transfer services as well. The results, in a short period of time, were impressive. In June 2000, $650,000 was transferred from the world to Bolivia via Prodem. In July, that amount rose 34 percent to $870,000. By April 2001, Prodem was conducting 40% of all Western Union transfers in Bolivia.

The introduction of savings products had to wait, first for the FFP's incorporation, and then, for approval by the Superintendent of Banks and Financial Institutions. Prodem was allowed to accept fixed term deposits from institutions early in 2000 and, by August, was able to offer them to the public at large. It had little difficulty attracting depositors, particularly at the national level, and by the end of the year had captured $15.5 million.

What was much more difficult for Prodem, and what has been challenging historically in Bolivia, was capturing savings at the branch level. In October 2000, Prodem piloted both its fixed term deposit and its savings account products in the rural branch of Caranavi. In three months, the branch captured approximately $50,000 in savings with an average of $191 per depositor, thirty percent of which was deposited in Bolivianos and seventy percent of which was deposited in US dollars. In those three months, the Caranavi branch mobilized more savings than any of the three other financial institutions in the area, all of which had been offering savings products for at least three years. Prodem deemed the pilot a solid success and is expanding its products nationwide in 2001.

The pilot was successful for many reasons, but two are worth mentioning here. First, Prodem introduced its savings products along with an innovative technology – the smart card. The smart card offered potential savers the two things that focus groups suggested mattered most: security and access. The digital fingerprint made it impossible for anyone but the saver to withdraw funds from the account, although up to three savers could be registered on the same card, for example, three members of the same family or business. Prodem could even set it up so that more than one fingerprint would have to be provided in order for funds to be accessed. Prodem did not require clients to show any kind of identification when conducting transactions with their smart card, so they could keep their important documents stored in a safe place rather than having to dig them out every time they wanted to conduct a financial transaction.

Since the smart card could be used at any of Prodem's 50+ branches, it provided clients with substantial access to their funds plus a cash-less technique for carrying funds from one place to another. Clients could use their card to view their savings balance and/or loan payment information at any time at any Prodem branch. Soon, they may be able to access their funds through automatic tellers in bus terminals and other points of commerce. Prodem is also considering the installation of card readers at local points of sale to facilitate purchases and payments by Prodem clients. The smart card proved attractive for social and cultural reasons as well. It quickly became a sign of status and prestige; for younger savers, it was hip. University students loved it, although the bulk of savers thus far have been between the ages of 30 and 45. Prodem pays a competitive interest rate on its savings products, from 4 to 6 percent annually depending on the degree of competition in the area, but that is not what attracted depositors in Caranavi. What attracted them was security, access and image.[*]

"*With 50,000 clients, any service can be profitable.*"

– Marcelo Maella

The second major reason for the initial success of Prodem's savings products was the marketing campaign with which the products were launched. In Caranavi, seven marketers went from house to house introducing the new products, explaining how they worked, and promoting their benefits. There were also advertisements on radio and television. The combination of mass-publicity with door-to-door marketing worked well according to focus groups. The publicity raised awareness and leant credibility to the promoters, who were then able to discuss the products in more detail and answer questions from potential savers whose interest had been peaked.

Prodem has not yet introduced a micro-leasing product, but it introduced a mortgage loan product in March 2001. Anyone with real estate can now obtain a 12-year line of credit from which they can borrow multiple times with a repayment period of up to five years. Interest rates vary with the amount of the loan and Prodem handles all the paperwork, including the valuation and registration of the asset, and the notarizing of documents. Later in 2001, Prodem will introduce a life insurance product. Borrowers will have the option of paying twenty cents per $1,000 of loan outstanding per month, and if they die, or if their spouse dies, the balance of the borrowers' loan will be paid by the insurance company and the

[*] Prodem offered a paper-based savings account for those clients who did not want to use a smart card, but only five percent of its savers have thus far chosen this option, most of whom are elderly.

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...eographic Diversification

...s explained above, expansion was on...
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Table 21: The Changing Compositio...

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New branches	
Total branches	
Major cities	
Secondary cities	
Peri-urban areas	
Rural areas	

Source: Prodem Monthly Program Indicators

Table 22: Comparing Competitors' ... 1999)

	Prodem	Ba...
Number of branches	51	
Urban branches	12	
Rural branches	39	
Number of localities served	47	
Regional coverage (%) [*]	100	

Source: Boletín Financiero Microfinanzas, Dece...

[*] Defined as a percentage of the number of d...

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o have thus far chosen this option, most of whom

surviving relative will receive $200 in cash. Prodem benefits from the deal in two respects. Its clients' loans are paid in the event of death and Prodem gets a percentage of the profits made by the insurance company on its sales to Prodem clients.

Geographic Diversification

As explained above, expansion was one of Prodem's primary strategies for delivering services affordably. To reach economies of scale in rural areas, Prodem opened a remarkable number of branches in the mid 1990s. This trend continued until 1999, although the character of Prodem's expansion changed in the latter part of the decade once its national presence began to solidify. Prodem had to re-establish itself in the country's core cities and major regional centers to link its rural branches to important points of commerce. It also needed to target branch openings in areas of the country that still lacked Prodem access. Table 24 shows the growth that resulted from this strategy, including the increase in the proportion of urban branches in Prodem's network between 1996 and 1998.

Table 21: The Changing Composition of Prodem's Branch Network

	1996	1997	1998	1999
New branches	6	8	10	1
Total branches	33	40	50	51
Major cities	0	4	4	4
Secondary cities	7	6	9	10
Peri-urban areas	4	8	12	12
Rural areas	22	22	25	25

Source: *Prodem Monthly Program Indicators*

Table 22: Comparing Competitors' Branch Networks (as of Dec 31, 1999)

	Prodem	BancoSol	Fades	Aned	Los Andes
Number of branches	51	43	22	21	16
Urban branches	12	43	3	5	14
Rural branches	39	0	19	16	2
Number of localities served	47	6	22	21	9
Regional coverage (%) [*]	100	56	78	89	67

Source: *Boletín Financiero Microfinanzas, December 1999*

[*] Defined as a percentage of the number of departments served.

By 1999, Prodem had achieved a national presence. As shown in Table 22, it had the largest number of branches of any microfinance institution in the country, and its network had significantly more breadth than that of any of its major competitors. The breadth of its network helped Prodem diversify risk across regions and also provided the foundation necessary to make its new wire transfer and savings services attractive. While BancoSol, Fades and Aned all closed branches during the year 2000, Prodem maintained its network as part of its competitive strategy.

Image

After an initial campaign in 1987, Prodem spent very little time or money selling its product or itself as an institution. It had no fancy offices, no flashy signs, and no advertisements in the newspaper. For years, clients did Prodem's marketing for it by spreading their personal stories via word of mouth.

With competition and the duplication of Prodem-style services, this began to change. Prodem had to work harder at selling itself, selling its services, and projecting an image that distinguished the institution in the marketplace. It began to produce marketing literature, to advertise its extensive branch network, and to capitalize upon its historic role in the sector, particularly in the creation of BancoSol. In 1999, it hired a marketing specialist at the national level who oversaw a complete makeover of Prodem's branches as part of the FFP transformation. New colors, a new logo, and a more uniform look and layout were all introduced to create an attractive and recognizable public image. In 2000, Prodem began holding corporate press conferences and its executives began accepting radio interviews. Television spots were developed featuring a famous local comedian and they were aired in rural areas. The idea behind all this publicity was not just to promote Prodem's new products, but to keep the institution as much in the public eye as possible.

> *"All roads lead to Prodem."*
>
> *– A billboard advertisement on the highway*

Strategic Planning

Another way Prodem responded to increasing competition was to increase the sophistication of its strategic planning. Each year, Prodem analyzes its strengths, weaknesses, opportunities and threats and uses the information to define annual and 3- to 5-year strategic plans that guide its operations and budgeting. In October, each branch draws up its plan and

projections. These are discussed at t
level, revised, and then passed to t
level for incorporation into an instit
plan that is presented to the board f
in December. Prodem then hold
meetings that bring together all
management to review perform
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experiences and strategies for specif

These detailed and participatory
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By spending more time on planni
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Business Units

Prodem's most recent strategy for
branches to operate more like busin
pressure of competition to motivat
ideas for making their branch profit
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projections. These are discussed at the regional level, revised, and then passed to the national level for incorporation into an institution-wide plan that is presented to the board for approval in December. Prodem then holds quarterly meetings that bring together all levels of management to review performance, to recommend changes in policy, and to share experiences and strategies for specific problem solving.

"We used to wait for the business to come to us; now we have to go out and create the business"

– Mario Cesar Colque, Branch Manager

These detailed and participatory planning activities help Prodem define where it wants to go as an institution and how it can get there. They also help facilitate the strategy's smooth and efficient implementation, since the people who ultimately do the implementing are the ones who design the activities and schedules contained in it.

By spending more time on planning, Prodem created the time and space within which to consider macroeconomic trends, competition challenges, shifts in supply and demand, etc. and to prepare strategies to respond to such external changes before a crisis hit. This, too, was important because it improved Prodem's ability to manage risk and allowed it to focus more on the creation of long-term competitive advantage.

Business Units

Prodem's most recent strategy for facing competition is to encourage its branches to operate more like business units. Executive managers use the pressure of competition to motivate branch managers to come up with ideas for making their branch profitable. Prodem still maintains general policies and standards for various categories of branches, but increasingly it treats each branch as a separate entity with particular needs in a unique market. Each branch is now encouraged to not only be aware of its own profitability but to also take responsibility for identifying new products or delivery methods that would improve that profitability. As Bazoberry said to one of his branch managers in April 2001, "If Prodem's current package of services does not meet your clients' needs, send me a proposal for what will."

"Did you make enough money to pay your salary today?"

– Eduardo Bazoberry addressing one of his branch managers

The business unit concept is also being adopted in an attempt to shift employees away from thinking about Prodem as a microlending institution to thinking about it as a microfinance institution. Staff can no longer sit and wait for clients to come ask for a loan. They have to take Prodem's business to potential clients, market it, convince potential savers that the institution can be trusted, etc. Prodem's business now extends far beyond credit and the focus on the branch as a unit of business is designed to help staff recognize that fact.

Managing Risk

As a lending institution, Prodem faced certain risks simply by nature of its being a financial services provider. The most serious of these was credit risk; the chance that its clients might not repay their loans. Like all lending institutions, Prodem tried to mitigate this risk by building mechanisms into its products' design and delivery that would 1) motivate clients to pay; and 2) ensure a good match between the level of credit extended to a client and that client's ability to service his or her loan.

For years, Prodem succeeded in maintaining an extremely high level of on-time repayment. Excellent portfolio quality helped maximize the productive use of its financial assets and minimize the time, energy and resources that the institution spent recuperating delinquent loans. This, of course, contributed positively to Prodem's drive for sustainability. The remainder of this chapter looks at some of the ways Prodem incorporated risk management into the design and delivery of its products. It also explores how Prodem's risk management strategies changed, not only because of increased competition, but also because of its new responsibilities to savers and investors.

The Message Given

Prodem's original product, the solidarity group loan, had two design features that distinguished it from traditional loan products. First, it relied on solidarity collateral rather than material collateral. What mattered in the delivery of this product was that the members of a group knew each other, trusted each other, and were willing to support each other—monetarily if necessary—throughout the entire loan process. It was an appropriate design for microentrepreneurs since most did not have security to guarantee a loan.

The second feature of the solidarity group loan product was its sequential character. Clients borrowed small amounts for short periods of time, and then renewed their loans for progressively larger amounts and longer terms. The product gave clients quick access to an initial amount of capital while minimizing Prodem's risk at the beginning of its relationship with a borrower. Clients' long-term access to capital was linked to their repayment performance. As long as a group demonstrated its ability and willingness to service a loan on time, Prodem generally increased the amount and term of its loan.

Designing an appropriate produ
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Designing an appropriate product for the microcredit market was important, but so was the process of conveying the loan terms and conditions to borrowers. For its solidarity group loan to be successful, Prodem had to explain the concepts of solidarity collateral and sequencing in a way that made sense to clients. Loan officers could not just give potential borrowers a piece of paper with the conditions of credit written on it. They had to find ways of making sure clients understood the rules and saw value in them.

An important communication breakthrough occurred when Prodem's original team realized that the solidarity group mechanism provided clients with access to credit using a concept that borrowers already applied in other aspects of their daily lives. In the local indigenous language of Aymara, this concept is known as "aimi" and refers to a person's willingness to help a neighbor today because of the expectation that at some future point in time that neighbor will return the favor. By explaining solidarity collateral through the "aimi" concept, loan officers helped clients quickly understand and see value in the joint liability mechanism. Most clients felt that organizing themselves into groups to access credit was a relatively low-risk, non-threatening way to increase working capital and stabilize cash flow.

It was harder, in general, for clients to find value in the sequencing concept. Many borrowers would have been happier had they been offered a larger initial loan with a longer repayment term. Nevertheless, Prodem managed to sell the sequencing feature by focusing on the issue of access. Even though many clients found sequencing inconvenient in the short-term, they were attracted by the opportunity to develop a relationship with Prodem that would give them access to capital in the long-term. This desire for future access was a key factor in motivating clients to repay their loans on time.

By starting small and making larger loans and longer repayment terms contingent on repayment performance, Prodem established a relationship of discipline with its clients. It sent the message that it was a serious lender that wanted to invest in microentrepreneurs over the long term. It was not a donor with a time-bound or project-focused agenda. It would not accept delinquency, and it would come to call on any borrower that reneged on his or her commitment to pay. Establishing this early credibility was important, particularly given Bolivia's history of bank failures and loan forgiveness. Prodem had to distinguish itself as a non-political, non-religious, non-government institution that was not giving any handouts. One page of its information session flip chart had pictures of a church, a government building, and several political party logos, each with a big "X" drawn through it.

Cognizant that larger loan amounts and longer terms were attractive to clients, Prodem not only maintained its policy of linking both to repayment performance, but it made the terms of linkage increasingly clear over time. By 1999, Prodem was stating the ramifications of repayment performance in very specific terms, as summarized in Table 23.

Table 23: The Link between Repayment Performance and Subsequent Loans

Number of Days Late	Next Loan Size	Next Loan Term
Two days or less	Up to 20 percent increase	Up to 50 percent increase
3 to 5 days	No change	No change
6 to 10 days	20 percent decrease	50 percent decrease
Over 10 days	Might not be eligible	

Source: Prodem

As competition increased, Prodem realized that it could no longer deliver a message that focused solely on its own approach and services. To maintain long-term relationships with clients, it needed to help them understand its products in comparison with those of other institutions and to see the dangers of borrowing from multiple institutions simultaneously. Prodem began to design its messages to improve the financial literacy of its clients.

By 1999, Prodem's information session not only explained its loan terms and conditions, but also provided a context within which potential borrowers could assess those terms. It briefly described the history of microcredit in Bolivia, and discussed the rights and responsibilities of the borrower. It compared Prodem's products with those offered by other institutions. It explained the impact of administrative fees, forced savings and flat vs. declining balance interest calculations on a borrower's effective rate. When it explained the restrictions Prodem set on its loans, it also explained the rationale behind those restrictions. For instance, instead of stating that its loans were non-transferable, it described the dangers of allowing someone else to use one's loan.

A financial literacy component could be found in the loan application and evaluation process as well. Loan officers worked with clients to determine an appropriate debt burden and were transparent about the process of how that is done. Without providing formal training, they offered clients insight into their financial situation, they explained why a requested loan amount might be too low or too high, and they provided "tips" to help clients navigate in an increasingly complex and changing market. In their monitoring and collection activities, loan officers spent an increasing amount of effort helping clients analyze risk, deal with overindebtedness, and understand the implications of market saturation on a client's business.

Even in the delivery of loans, a financial literacy component was found. Staff in the Betanzos branch read and explained the implications of every item in Prodem's written contract. They discussed the principles behind the legal language to ensure clients understood the conditions of the loan. They then left the group alone to discuss the conditions before deciding whether or not they wanted to sign the contract. This approach signaled a degree of seriousness about the lending process and a desire to work with clients to increase their capacity to make informed financial decisions.

One may question whether such a financial literacy strategy is sustainable, but Prodem's decision to incorporate a financial literacy component into the launch of its savings products suggests that it finds the strategy valuable, at least in the short-term.

Screening and Evaluation

For years, Prodem's principal screening and evaluation mechanism was the solidarity group. The members of each group selected each other, evaluated how much each member could afford to borrow, guaranteed each other's loans, and monitored each other's repayment. As long as Prodem got its messages across effectively early on, loan officers needed only to play a secondary screening function, which was designed to protect the institution from fraud. Before recommending a loan for approval, they verified that the individuals who presented the loan application were real persons and not just names on a piece of paper, that they lived in the same neighborhood, owned their own businesses and had been operating for at least one year.

Loan officers established the terms of each group's initial loan by gathering basic data on business sales, assets, expenses and credit requirements and then choosing an amount and payment period from a standard range of options. For years, loans were almost automatically renewed with longer terms and in larger amounts as long as group members continued to prove that they could and would service their loans in a disciplined manner. Re-evaluations of clients were unnecessary as long as the loan amounts remained relatively small, and the clients maintained an excellent repayment record. In general, it was a cost-effective and efficient system that provided a sufficient degree of protection against risk given the environment in which Prodem operated at the time.

There were limits, however, to the usefulness of the solidarity guarantee and sequencing as screening and evaluation tools. While joint liability helped to ensure that groups would consist of members with good intentions, it could not help protect against the group as a whole believing it could take on a larger debt than was realistic given its cash flow. Since the stepped lending process enabled Prodem clients to borrow progressively larger amounts as long as they maintained a good credit history, their debt burden naturally grew with time and, if left unchecked, would eventually grow to a point at which clients could no longer service it. Increasingly, Prodem saw the need to develop more sophisticated screening mechanisms that could assist it in determining clients' debt capacity.

The most significant changes made were in the economic evaluation process. With input from the field as well as from financial management staff, Prodem developed new evaluation forms to assist loan officers in more accurately assessing a borrower's financial situation. The new forms created a balance sheet, income statement and cash flow statement for each potential borrower. They distinguished between the assets and liabilities of the business and of those of the borrower's family, but they analyzed cash flow using the borrower's household as the economic unit. Given the fungibility of money and the non-directed nature of Prodem's loans, the household-based cash flow gave a more accurate picture of a borrower's ability to pay than a narrow analysis of the business' cash flow. The new forms also incorporated a set of financial indicators to assess the liquidity, debt, profitability, and operational efficiency of the borrower's business (see Table 24).

Table 24: Selected Economic Analysis Indicators

Liquidity Indicators
Current Ratio
Working Capital Ratio
Acid Test Ratio
Efficiency Indicators
Accounts Receivable Turnover
Inventory Turnover
Profitability Indicators
Gross Margin
Operating Margin
Net Margin
Return on Assets
Break-even Point
Debt Indicators
Total Liabilities as a Percentage of Total Assets
Level of Indebtedness if Loan is Approved

The increased detail and sophistication of the forms required more sophisticated analysis to apply them effectively. Prodem designed and implemented a series of training seminars in economic evaluation for all of its loan officers to increase their exposure to and applied knowledge of financial analysis tools. Additional seminars were held to improve field the usefulness of the solidarity guarantee evaluation tools. While joint liability would consist of members with good ct against the group as a whole believing n was realistic given its cash flow. Since d Prodem clients to borrow progressively intained a good credit history, their debt and, if left unchecked, would eventually could no longer service it. Increasingly, ore sophisticated screening mechanisms clients' debt capacity.

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officer evaluation of guarantees and documentation, and a third is being developed to enhance their ability to identify risk.

In 1998, after watching impressive growth rates turn into alarming arrears rates in several branches simultaneously, Prodem made other changes in its screening methodology, most of which focused on being more aware of the external environment. The national office negotiated monthly access to Bolivia's credit bureau and began distributing this information to its branches so they could avoid lending to clients who were already heavily indebted or who had already defaulted on loans with other institutions. It developed market monitoring systems that gathered more information from third party sources about the current and projected conditions of the markets in which it operated. Loan officers put more time and energy into the screening process, relying less on clients' honesty and more on the economic evaluation process described above. They also took greater care in cross-referencing information sources using their own observations, social evaluations, etc. to help assess both a borrower's ability to repay and his or her attitude towards repayment.

The question of how Prodem could afford more extensive screening and evaluation procedures was already answered, in large part, earlier in this chapter. There is, however, one additional point worth mentioning in this context. Prodem did not move from a completely standardized to a completely customized approach. Rather, it developed a hybrid solution. With smaller loan amounts and newer clients, Prodem continued to use the cost-efficient peer group and sequencing mechanisms to screen and evaluate clients. With larger amounts and individual clients, it used more traditional tools to evaluate each client's cash flow and collateral requirements. This more customized approach was made affordable primarily by the larger average loan size of these clients, and once again, by Prodem's resourceful application of technology. By 1998, loan officers in several branches had designed spreadsheets in Microsoft Excel that enabled them to record and track client cash flows by computer rather than by hand. Many are now using hand-held microcomputers such as the PalmPilot to process cash flow and economic analysis at the client's place of business rather than having to return to the office. When efficiencies such as these were combined with increasing economies of scale, staff productivity, and low delinquency, the hybrid approach became feasible.

Responding to Delinquency

For years, the driving force behind Prodem's risk management strategy was its zero tolerance for delinquency. From the day the institution opened its doors, Prodem aimed for 100 percent repayment and for most of its history, it came impressively close to meeting that goal. Its end of the month 30-day portfolio at risk rate rose above 3 percent for the first time in March of 1994. It then remained below 3 percent until October of 1998. Prodem achieved such strong performance in this area primarily because of its immediate and appropriate follow up on delinquent payments.

Prodem's branches usually scheduled repayments on specific days of the week. At the end of each collection day, loan officers printed a report that listed the names of the groups that had not yet paid. They then went out either that afternoon or early the next morning to visit the members of the delinquent groups, find out why they had not paid, and help them find a solution to their repayment problem. The type and degree of positive or negative pressure applied by the loan officer varied by region and by group. For example, in some small towns, loan officers found that personal visits to clients' homes were counterproductive. Borrowers considered the visit to be social event that they welcomed regardless of the purpose; some even went so far as to purposely not pay their loans to provoke a visit. When the loan officer arrived, the money would be waiting for him and dinner would be on the table.

> *On loan repayment dates, cashiers printed a list of all payments due on that day. As clients made their payments, the cashier highlighted the name of the group or individual on the list and had the person making the payment initial it. As the day progressed, loan officers could easily discern which groups had not yet paid and could immediately follow up with a friendly reminder. At the end of the day, cashiers entered only the names of delinquent groups and with one computer command marked all other payments as made. The process was time-efficient and facilitated rapid follow up on late repayment, which was Prodem's key strategy for controlling arrears.*

Regardless of the problem, by following up on delinquency immediately, Prodem was generally able to work with groups to resolve issues before they became serious. Beginning in 1998, however, delinquency became more of a problem. While the level of delinquency at the institutional level never reached an alarming rate, an increasing number of branches began to have serious portfolio problems. Besides their immediate follow up on delinquent payments, loan officers sought other strategies for motivating clients to pay and to pay on time.

Several branches implemented a "scorecard" system in which borrowers' repayment booklets were stamped with a symbol that reflected the timeliness of each payment made. One branch used happy and sad faces, another used stars, and another used different colors to indicate

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whether a group had repaid on the morning of their payment due date, on the afternoon of their payment due date, or after their payment was due. Group members were encouraged to use the stamps as a way of keeping their group coordinator accountable. They were also encouraged to compete with each other to see "who could collect the most stars."

Most branches revised their collection strategy to include not only rapid, but repetitive follow up on delinquent clients. The idea was that by putting steady pressure on borrowers and borrower groups that were hesitant to solve their repayment problems, Prodem could induce a resolution. Loan officers visited delinquent borrowers on a daily basis. They refused to accept partial payments in an effort to encourage the joint liability mechanism to kick in. In some branches, loan officers asked each client to sign a form after every delinquency visit that recorded the meeting and its outcome. They found that by stating clients' delinquency in writing they were able to increase the seriousness with which borrowers perceived the situation, and this led to some additional repayment.

The intense collection strategy produced some results, but it was exhausting for loan officers. They began to collaborate more in their management of delinquency and in their search for creative solutions to difficult repayment problems. They held daily delinquency meetings to brief each other on their activities and their progress or lack thereof, and to design a plan of attack for the following day. "Blocks" of agencies in the same region came together informally to help each other act on arrears. The exchange was supportive in both physical and mental terms, providing new energy and ideas with which to continue addressing delinquency issues.

Ultimately, however, there was a substantial increase in the number of clients who, for whatever reason, were not servicing their loans. In 1999, Prodem decided, for the first time in its history, to refinance the debt of some of those clients who clearly wanted to make payments on their loans but could not do so for circumstantial reasons. To be eligible for refinancing, clients had to have paid at least 40 percent of the amount due on their loan and have a clear intention to continue servicing their debt. A new contract was drawn up which doubled the remaining time period within which they were supposed to pay off their loan, and spread payment of the remaining debt over the new period in equal, regular installments. If the terms of the new contract diverged in any way from this norm, clients had to provide some form of real collateral in order for the loan to be rescheduled.

For those clients who, in Prodem's estimation, could have serviced their loans, but simply chose not to, Prodem took a much more aggressive stance. It threatened, and then delivered on its threat, to submit the names of delinquent borrowers to the national credit bureau, effectively eliminating their access to credit from any institution in the near future. It also publicized the names of delinquent borrowers in local newspapers, and in some cases initiated legal proceedings. Because of the cost and complexity of engaging the legal system, Prodem applied this last strategy selectively, but it did so effectively enough to establish itself as a serious financial institution that was willing to employ legal mechanisms as necessary to recuperate its funds.

Monitoring and Control

Naturally, the increased delinquency, the economic recession, the excess supply of credit, and the launch of the private financial fund all motivated Prodem to rethink the way it monitored and controlled risk. For years, Prodem relied heavily on the members of its solidarity groups to self-monitor one another and ensure that each member fulfilled his or her responsibilities to Prodem. It also used the regular payment schedule inherent in both the individual and group loan products as a built-in mechanism for gauging clients' continued willingness and ability to service their debt. Loan officers did not have to follow up with all of their clients every week; they only needed to follow up with the ones that did not show up to make their payment.

In general, Prodem's system of monitoring and control was both efficient and effective, and so it remained largely unchanged for almost a decade. In 1995, Prodem made its first major adjustment to its monitoring program when it removed the condition that required clients to invest their loans exclusively in their business activities. Prodem did this in recognition of the fungibility of money, i.e. the tendency of households to collect their income and pay their expenses out of one large pot without keeping track of what income is destined to pay what expense. Prodem realized that directed lending was expensive to monitor and took money management flexibility away from clients without adding much value in terms of risk management. Thus, it decided to relinquish control over the destination of its loans and focus instead on making sure its clients had the ability to pay them. This decision helped fuel the changes in Prodem's evaluation and screening mechanisms that were described above.

Prodem made many more adjustments to its monitoring and control strategy by the end of 1999. These were, in part, a response to changes in the external environment, but they were also in preparation for the creation of a private financial fund. In anticipation of increasing volume, additional operational complexity, and a relatively unstable economic environment, Prodem introduced new monitoring mechanisms and

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Moving Up and Out

The prolonged recession made
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established clearer guidelines for the application of existing ones. For example, it set limits on the degree to which loan amounts and terms could increase, and these limits were incorporated into the computerized information system so that entries outside of the limits would not be accepted without the approval of management. Branch managers could approve loans up to $2,300 and regional managers could approve loans up to $10,000, but anything larger than that had to be approved by a national manager.

Prodem turned the credit committee into a feedback committee and made individual loan officers accountable for the applications they approved. It hired full-time cashiers to avoid the risks inherent in having loan officers evaluate, approve and disburse loans. The lack of an effective check on loan officer discretion had permitted fraud in several branches and Prodem wanted to address that. Its creation of an employee pension fund and profit-sharing reward system was also designed, in part, to discourage fraud and to encourage employees to monitor institutional performance as if Prodem were their own business.

Prodem created an asset and liability committee, a risk committee, and an internal audit committee. It installed security cameras and alarms in its branch offices. It also incorporated additional legal tools into its contract design. All written contracts now include a clause that requires clients to declare that the information they provided during their economic evaluation was true. In addition, if any member of a group requests a loan greater than $800, the contract's signing must now be notarized.

As mentioned previously, Prodem also increased the sophistication and regularity with which it collected and analyzed information on its external environment. This included data on the national economy, industry conditions and competition in the financial services industry. After introducing a regional layer of management in 1997, Prodem's national managers were able to spend more time analyzing such data, identifying trends, and preparing organizational responses. Being able to anticipate and plan for environmental change not only helped Prodem design and deliver more effective products, but also helped it control the impact of external change on the institution.

Moving Up and Out

The prolonged recession made Prodem realize that there was only so much risk that could be controlled through monitoring and delinquency management. By the end of April 2001, the banking sector's portfolio-at-risk greater than 30 days had risen to 14.2 percent, the highest level recorded in the last decade. More strikes and marches were being launched, and a 3-month blockade of the country's major transport arteries was threatened. Debtor associations were among those marching and arguing vociferously on popular radio stations in favor of debt forgiveness and loan reprogramming for small borrowers. Financial institutions of all shapes and sizes were beginning to question how much longer they would be able to stay afloat.

No matter how strong an institution Prodem may have been, the nature of its business made its future precarious. Especially once it started capturing savings from the public, Prodem felt the need to adopt a more radical approach to risk management. It made three major changes in its product design and delivery in an effort to stabilize its situation.

First, it shifted the majority of its loan portfolio to individual lending. At the end of 1999, 84 percent of its portfolio was made up of solidarity group loans. One year later, it was only 59 percent. By the end of 2001, Prodem predicts that a mere 26 percent of its portfolio will consist of solidarity group borrowers. Why the immense shift? Prodem learned that the solidarity group loan product does not work effectively in periods of prolonged economic distress. The first time someone in a typical group had a problem, the methodology worked as designed. The group supported the member in trouble and the problem was resolved. The second and third times someone had a problem, the group usually found a resolution as well, but by the time the fourth problem arose, everyone in the group was already having such a difficult time that they could not resolve the problem. Technically, that put the entire group into default and Prodem had to provision not only for the loan of the member who had the problem, but also for all other members of the group. Technically, no one in the group could get a new loan until all of the members had repaid their loans and this was a huge disincentive to pay. The solidarity group methodology broke down. Managing the problem became very complicated and time consuming for Prodem, to the point that it decided to encourage clients to borrow individually instead. Today, solidarity group loans are still available, but only for terms of six to eighteen months and only for $2,200 maximum. Individual loans can now be secured in a number of ways: with a personal guarantee, a fixed term deposit, a telephone line, machinery, vehicles, equipment, or with documents in deposit.

Second, Prodem is deliberately moving up-market. Between December 31, 1999 and December 31, 2000, its portfolio grew three percent, but its client base shrank by 27 percent. Its average loan rose from $606 to $860. Prodem maintains that it is not abandoning its original market, but is consciously moving up market in an effort to stabilize its situation. Previously, it concentrated its business in the lowest level of the economic triangle, but this was the level worst hit by the crisis, and with a few more years of bad news ahead, Prodem knew it would be vulnerable there. By moving slightly up-market, it could diversify its risk and also tap into a larger client base for its non-credit services. Prodem's two strongest competitors, BancoSol and Caja Los Andes, have already done exactly that. As an interesting side effect to the up-market move, Prodem has realized that it has not yet identified appropriate financial products for serving its poorest clients and it is returning to the field once again to study what might be more effective. It is looking, in particular, at the practices of local moneylenders.

Third, and finally, Prodem is diversifying its business activities into areas other than microfinance and will soon create a holding company that will manage the FFP, a software company, and a consulting company. Prodem had been receiving requests for advice and technical assistance from other microfinance institutions for years and had been generating a small stream of income to compensate it for the time spent with visitors. Once it became an FFP, however, Bolivian law prohibited it from engaging in activities other than financial intermediation, and that is what sparked the idea of creating a separate consulting company. In the very near future, Prodem will be able to send "expert operators," as it calls them, to the field to pass on lessons learned and help other microfinance institutions build capacity that Prodem has already developed. Besides generating an additional source of revenue through experts' fees, the consulting business should offer excellent exchange and professional development opportunities for staff, and provide a creative way to make productive use of the FFP's human resources during slow periods at home. The company is in the final stages of its constitution and already has its first contract pending with UNDP's MicroStart in Guatemala.

Plans to create a software company came about in a similar manner, but grew out of the very successful working relationship that Prodem and Wiñay Pacha have enjoyed since 1997. With Wiñay Pacha's support, Prodem developed a number of technology products and software modules that other microfinance institutions are now interested in using, so the two organizations decided to set up a company to market their products, to provide implementation and maintenance services, and to offer the development of new software solutions. Interestingly, they plan to make the business multidisciplinary in its scope and will not limit their services to the microfinance industry. A list of some of the services that the two companies are ready to offer is provided in Table 25.

Table 25: Selected List of Services Provided by Prodem's New Companies

Consulting Services
• Financial (budgeting, financial projections, financial analysis)
• Credit (solidarity group methodology, individual lending methodologies, delinquency management)
• Marketing and Sales (design of rural and urban branches, development of savings and credit products, market research, focus groups, marketing and client service, public relations strategies for rural areas)
• Human Resources (personnel selection, institutional development, corporate culture, incentive schemes, financial analysis training, economic evaluation)
• Other (political norms associated with the microenterprise sector, strategic planning, business plan elaboration, corporate governance)
Technology Products
• Smart cards
• Digital fingerprint
• Automatic tellers
• Software for hand held computers
Software Modules SiPRO v1.0
• Accounting
• Treasury
• Portfolio
• Lines of credit
• Fixed term deposits
• Savings
• Money transfers
• Cashiers
• Personnel administration
• Purchasing
• Fixed assets
• Back-up
• Communication and closure
• Security

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Strategic

Prodem built impressive institut and a half of operation, but i external actors contributed the to augment those already possessed relationships were constructed and n once foreign in nature was transferr the institution's development.

This chapter describes Prodem technical assistance providers, its d ways in which those relationships— actors—influenced Prodem's growth recent attempt to form a different another microfinance institution, an can be learned from the failure of th

The Prodem – Client Relat

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CHAPTER 7
Strategic Alliances

Prodem built impressive institutional capacity during its first decade and a half of operation, but it did not do so alone. A variety of external actors contributed their own financial and human resources to augment those already possessed by Prodem. Because of the way these relationships were constructed and nurtured, much of the capacity that was once foreign in nature was transferred to Prodem, contributing greatly to the institution's development.

This chapter describes Prodem's relationships with its clients, its technical assistance providers, its donors and its investors, and explores ways in which those relationships—and not the mere presence of external actors—influenced Prodem's growth. It also takes a brief look at Prodem's recent attempt to form a different kind of alliance - a merger - with another microfinance institution, and it examines some of the lessons that can be learned from the failure of that deal.

The Prodem – Client Relationship

Had Prodem's goal been simply to make credit available to the informal sector in the hope of generating economic growth, its relationship with its clients would have been a fairly commercial one, with Prodem as the supplier of a service and microentrepreneurs as the buyers. Since Prodem's goal was ultimately developmental, however, its relationship with its clients assumed a fundamentally different character. Clients were not just customers; they were also partners in the building of an institution that could contribute to the development of marginalized Bolivian families.

An Exchange

Prodem's clients made two significant contributions to the institution's development. First, they provided it with motivation. Prodem's founders were inspired to create a microlending institution because they saw the potential of Prodem's target market. They believed that if microentrepreneurs could access appropriate and sustainable financial services, they would be able to stimulate economic development in their communities. Staff, too, believed in this mission, but it was the hands-on experience of lending to microentrepreneurs that inspired their work. Through personal stories about what credit had enabled clients to achieve, staff realized just how great an impact a series of small loans could make. They observed tangible changes in the productivity and volume of clients' businesses and, later, in their social behavior, such as improvements made to their homes, and an increased tendency to send their children to school and to health clinics. More than any other factor, this demonstrated impact is what motivated employees, particularly field staff, to give Prodem their best effort, to go beyond what was expected of them, and to pursue the highest standards of quality and service year after year.

"Both clients and credit officers believe that the program belongs to them and that only through hard work by both clients and employees can the program survive."

– Amy Glosser, in "The Creation of BancoSol in Bolivia"

When Prodem began lending, it sought to build a relationship with its clients by offering two things: 1) confidence in microentrepreneurs' abilities, and 2) cash. Of course, potential clients approached Prodem because they wanted access to credit, but they were impressed by the respectful and trusting manner with which they were treated by Prodem. Prodem aimed to serve poor people who were discriminated against as the poor in any country generally are.[60] Banks would not serve them and development projects often treated them with condescension, or as beneficiaries of a donation, rather than as productive contributors to society. In most cases, Prodem was the first institution to offer them access to credit and to do so professionally. Clients quickly came to regard Prodem as an ally—as a serious institution that wanted to see its clients succeed.

Clients coined the slogan that Prodem now uses in its marketing literature, "Prodem gives you opportunity."

The relationship between Prodem and its clients deepened from there. Respect and trust bred respect and trust. Clients became increasingly open

[60] Claudio Gonzalez-Vega, et al., "A Primer on Bolivian Experiences in Microfinance: An Ohio State Perspective" (Columbus, Ohio: Rural Finance Program, Ohio State University, no date).

"Both clients and credit officers believe that the program belongs to them and that only through hard work by both clients and employees can the program survive."

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r on Bolivian Experiences in Microfinance: An
Rural Finance Program, Ohio State University,

with Prodem, and Prodem became increasingly attentive to what clients had to say. An exchange ensued that was facilitated primarily by Prodem's loan officers, who often came from a similar ethnic and economic background as their clients. They spoke the local language with a local accent and understood local customs. In rural areas in particular, there was no major social or cultural distinction between loan officer and client, which facilitated a level of comfort between the two parties that would not have been possible otherwise. Loan officers developed personal relationships with their clients. Through casual conversations, they gathered information not only about their clients' business activities, but also about their families, their communities, their social expenditures and needs, and their priorities.

Prodem's loan officers made a point of knowing their clients' names, greeting them on the street, inquiring about their family and their health and not just their business.

By sharing this information, clients made their second major contribution to Prodem's success. Prodem could not have built an organization that supported Bolivian development were it not for its insight into the needs of Bolivian microentrepreneurs and the ways in which it, as a lending institution, could best meet those needs. Prodem's clients provided this insight. They not only offered information about their own situations, but also gave Prodem feedback about the adequacy of its services. They pointed out things they liked and did not like. They explained why certain aspects, such as the standardized repayment scheme, created problems for them. They let Prodem know when they felt the competition was offering a better deal than Prodem offered them.

As explained in the previous chapter, Prodem used this information to improve its operations, to manage delinquency, to combat desertion, to design new products, and in general, to strengthen itself as an institution. What is interesting to note here is the role that the Prodem-client relationship played not only in the identification of problems but also in the design and implementation of solutions.

Take, for example, the process of delinquency management. Prodem's relationship with its clients gave it information about borrowers' spending patterns, their ability to make loan payments and the factors that motivate their repayment, and this helped Prodem structure its loan products. The relationship also gave Prodem the opportunity and the means to explain to clients why on-time repayment is important. It helped loan officers identify potential repayment problems and encouraged clients to approach Prodem in advance if they thought they might not be able to make a payment so that together they could find a solution. The solution in many cases simply meant approaching the client's group members to ask for temporary support. It was nothing extraordinary, but the fact that a solution was negotiated in advance, with relative calm, and with the involvement of both Prodem and its clients kept minor problems from becoming major crises and maintained a productive relationship between the two parties.

It is unlikely that exchanges such as this would have taken place were it not for the nature of the relationship that Prodem built with its clients. Under less favorable conditions, Prodem could have asked its clients questions, but it might not have received answers, or if it did, the information shared would have likely been inaccurate. Certainly, the chances of clients providing unsolicited information about themselves, their businesses and their communities would have been greatly diminished and Prodem's ability to understand and serve its target market would have been negatively affected.

A Changing Relationship

> *"Okay, we'll stick with Prodem, but you have to show us that there will be a change."*
>
> *– Clients from the Caranavi branch voicing their dissatisfaction with the flat rate administrative fees*

Over time, Prodem's relationship with its clients changed. This was due, in part, to Prodem's own success in making credit accessible to low income entrepreneurs and helping them understand how the credit process worked. The better clients understood the system, the more demanding they became about the terms of the loan they received. This was a generally positive trend since it pushed Prodem to be more efficient and effective in its service delivery. However, as clients became more sophisticated in the use of credit, their ability to abuse Prodem's trust-based system also increased. Prodem had to deal with an increasing amount of fraud and manipulation by clients who wanted to take advantage of the system, and it became more wary and less likely to trust its clients at their word. It adopted more sophisticated screening mechanisms and this increased the degree of formality with which it interacted with its clients.

A second factor influencing Prodem's client relationship was the increase in the supply of credit offered to its borrowers by other institutions. Clients no longer had to remain with Prodem to obtain access to credit. They could pick and choose among loan providers, and since they had a basic understanding of how the credit system worked, they did pick and

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choose. Again, this was a generally positive development because it encouraged efficiency improvements in microlending operations and resulted in lower prices for borrowers. It also encouraged Prodem and other lending institutions to think about what other types of services they could offer microentrepreneurs now that the credit market was becoming saturated. At the same time, however, the increase in the supply of credit made it possible for microentrepreneurs to borrow from multiple institutions simultaneously. Many became overindebted, and microlending institutions had no mechanism for obtaining the information from their competitors that would have been necessary to prevent this.[91]

The third major factor influencing Prodem's client relationship was the economic recession of the late 1990s. For the first time ever, multiple Prodem branches experienced 30-day portfolio at risk rates above 20 percent. Overindebted clients were unable to pay their loans. Even clients who had not borrowed from multiple institutions found themselves in trouble. The situation fundamentally altered Prodem's relationship with its clients, not so much because of the arrears, but rather, because of the number of cases in which Prodem had to discontinue a client's access to credit. Previously, Prodem went to great lengths to build long-term relationships with all of its clients as the means through which it supported Bolivian development. Recent changes made Prodem realize that the only clients worth retaining were the ones who wanted to retain their relationship with Prodem.

"We're lost if there isn't a good relationship between credit officer and client."

– Daysi Orusco

One of the most interesting challenges now facing Prodem Oportunidad, FFP is client retention. The FFP has already decided that the only sustainable means of retaining clients is to consistently provide services that are valuable to them, but to offer such services, Prodem will have to stay in tune with clients' changing needs, expectations and desires. In the past, it did this through its close, personal relationships with clients. These relationships were key to establishing trust (which is central to the success of any financial institution) and solidarity. For many years, the Prodem-client relationship was a strategic alliance because it was a

[91] In a 1999 survey of borrowers from a variety of Bolivian microlending institutions, Paul Mosley calculated an average debt-service ratio for the borrowers interviewed of 58 percent. See Mosley, "Microfinance and Poverty: Bolivia Case Study," Background paper for the World Development Report 2000/01, AIMS paper (Washington, D.C.: Management Systems International, May 1999) 24. Non-regulated institutions had no access to the national credit bureau.

mechanism through which Prodem and its clients could pursue common interests. Their alliance was critical during the creation of Prodem's urban and rural lending programs, when numerous paradigms had to be broken. One can argue, however, that the alliance is less important now that Prodem, and microfinance, are established in Bolivia. Clients are probably becoming more concerned with access to water, health, education, and roads than they are with access to financial services. They may continue to have a strategic alliance with the Prodem Foundation as it seeks new ways to support microentrepreneurs' development, but their relationship with Prodem Oportunidad, FFP is likely to become more commercial. They will buy a financial service from Prodem if they like the way it looks, if they like the way Prodem treats them, and if the price is right. They will leave it up to Prodem to figure out how to make its service attractive.

The Technical Assistance Relationship

A second strategic alliance existed between Prodem and its technical assistance partners. These relationships were strategic because they gave Prodem access to knowledge and financial resources that it would not have had otherwise, and because they did so in a way that facilitated the transfer of expertise, technology and connections to Prodem for its own future use. The assistance was particularly useful because it came primarily from two well-respected institutions, Acción and Calmeadow, which both made long-term commitments to Prodem at critical stages of its development, and because these two technical assistance providers coordinated their policies and participation to provide a coherent framework of support for Prodem. Had the institution received sporadic support from a wide range of technical assistance providers with differing philosophies, the relationships would surely have been less influential.

The Contributions of Acción

Prodem would not exist had it not been for Acción. It was Acción's Chairman, Jack Duncan who first put the bug in Fernando Romero's ear that led to Prodem's creation. Acción played a key role in bringing together the strategic group of actors that ultimately founded the institution. It helped Prodem build its relationship with USAID, one of the two donor institutions that has been most supportive of Prodem over time. It also helped write and negotiate funding proposals that secured the core resources for Prodem's first year and a half of lending activity.

On the operational side, Acción provided Prodem with a lending technology that had already proven successful in other Latin American countries. Because of this intervention, Prodem was able to hit the ground

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running and build upon the experiences of other institutions rather than having to start from scratch. Acción also played a fundamental role in helping Prodem develop its institutional culture. It designed and implemented the series of management and communication seminars that Prodem quickly internalized and made a mandatory part of its training program. These seminars introduced the core set of values that guided much of the institution's interaction with its internal and external clients.

Perhaps Acción's most important early contribution was the identification of Pancho Otero as Prodem's first executive director. Acción hired Otero and paid his salary until 1990. It made most of its subsequent investments in the institution through Otero, providing him and his core staff with training and exchange opportunities. This support was part of Acción's strategy of identifying local leaders to serve as managers for its affiliates, building their capacity, and entrusting them to apply their new knowledge. Acción often brought these local leaders together and facilitated their sharing of ideas, experiences and strategies. They brainstormed possible solutions to problems and provided each other with feedback on future plans. Since microlending in Latin America in the 1980s was still in an experimental stage with a great deal of innovation happening all at once, Acción provided an important and appropriate mechanism for learning while doing and in the process created a valuable network of peer support.

In the early 1990s, Acción changed its support strategy. Increasingly, its affiliate institutions needed technical assistance that could not be provided by peers. They needed more sophisticated financial management and planning tools, and sought experts who could help them adapt these tools to the microfinance context. Acción turned its attention to the development of such tools and to the identification and financing of experts who could respond to requests from its affiliates for technical assistance in very specific areas. It also began to identify key best practices in microlending and promoted these throughout its extensive network.

Prodem was a prime example of an institution that had sped ahead of its peers and was in need of external technical assistance. In the early 1990s, it was in the process of creating Latin America's first microenterprise bank. It benefited tremendously from Acción's shift in strategy because it needed the financial management and planning tools, the experts, and the financing that Acción was prepared to offer. It gained credibility and visibility through Acción's local and international support of its commercial approach to microfinance. Acción put Prodem in touch with influential bankers and financiers who could help make its case from a legal, commercial and regulatory perspective. It also helped Prodem negotiate donor agreements that enabled it to become a major shareholder in the new bank.

Prodem was a member of the Acción network until 1999, and Acción continued to be supportive of Prodem during that time. It implemented two external CAMEL evaluations for Prodem, one in 1994 and one in 1997, that were useful in the institution's strategic planning process. In 1998, it provided Prodem with a $500,000 letter of credit through its Bridge Fund. Prodem also took advantage of the general benefits of affiliate membership, such as the networking opportunities provided by regular international conferences, although the more active advisory role once played by Acción was largely passed to another technical assistance provider by 1993, the Canadian NGO, Calmeadow.

The Contributions of Calmeadow

As mentioned in Chapter 1, the relationship between Calmeadow and Prodem began with the friendship forged between Martin Connell and Fernando Romero. Their friendship grew into an institutional relationship by early 1988 when Calmeadow helped Prodem resolve a temporary funding gap. Prodem's USAID funding had been frozen unexpectedly as a result of the US Government's anti-drug campaign against Bolivia and Prodem found itself facing a liquidity crisis less than a year into its operations. Calmeadow's willingness and ability to obtain emergency funding for Prodem through CIDA's local monetization program cemented a special relationship between the two institutions.

The liquidity crisis was part of what led Connell and Romero to recognize the limitations of the NGO framework as a mechanism for making microfinance available to large numbers of microentrepreneurs. Once those limitations were recognized, Calmeadow made its first major contribution to Prodem's future development by encouraging the pursuit of alternative institutional frameworks. It promoted and funded a preliminary study in late 1988 that explored the idea of creating a microenterprise bank. When the study concluded that the idea was viable and Prodem's leadership decided to pursue the creation of the bank, Calmeadow helped establish the committee that implemented the transition process (COBANCO), and it provided major financial and technical support for the committee's work.

> *"We've seen our role evolve as Prodem has evolved."*
>
> *– Barbara Calvin, Calmeadow*

In 1991, it sent Douglas Salloum, a commercial banker who was then serving as Calmeadow's Finance Officer, to spend six months in Bolivia to o become a major shareholder in the

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, a commercial banker who was then cer, to spend six months in Bolivia to

help develop BancoSol's first business plan and financial projections. During that period, Salloum was COBANCO's main link with the Bolivian Superintendent of Banks and played a key in role in the committee's ability to develop a credible and collaborative relationship with the Superintendent. Together with Acción, Calmeadow also financed the participation of Miguel Taborga, former director of fundraising for the Bolivian Social Emergency Fund, as COBANCO's Project Manager and worked closely with Taborga to help mobilize resources to capitalize the new bank.

Calmeadow made its second major contribution to Prodem's institutional development after BancoSol became a reality. By mid-1992, the majority of Prodem's early supporters had turned their attention away from the NGO and toward the bank. This was a natural response to the bank's cutting edge agenda, but it was also the result of Prodem's focus on negotiating a smooth transition of its lending activities to the bank and its consequent delay in forming consensus around a new mission for the NGO. When Pancho Otero moved to BancoSol full-time and Eduardo Bazoberry assumed the position of Executive Director of Prodem in early 1993, Calmeadow offered support to Prodem in the process of defining its new path.

Prodem's fundamental challenge during that time period was to redefine its identity and choose a new focus for its future activities. Calmeadow worked with Prodem to analyze the different possibilities, to decide which to pursue, and to design a program of activities that Prodem could present to donors. It supported Prodem during the transition period by providing technical expertise in strategic planning and financial analysis, and by helping to organize the process as a whole. It gave Bazoberry and his team a strong dose of moral support and a boost of confidence in their aspirations for the institution.

Calmeadow also helped Prodem secure its financial independence. At the time, it was feared that dependency in the relationship between BancoSol and Prodem would hinder the development of both institutions. Investors would not want to finance a bank that depended on subsidies from a NGO, and donors would not want to fund an NGO that subsidized a for profit entity. Calmeadow was among those who lobbied hard for a no-subsidy policy between Prodem and BancoSol. Towards that end, it recruited Toronto Dominion Securities to develop a pricing model for the sale of Prodem branches to BancoSol, one that recognized and compensated Prodem for the costs of developing branches for the bank. Calmeadow also assisted Prodem in presenting a five-year plan to the Canadian International Development Agency (CIDA) and successfully lobbying for the agency's significant support of that plan. The funding received, together with the revenue generated by the sale of Prodem branches to BancoSol, gave Prodem the financial strength to get started as an independent institution with an agenda and with a personality distinct from that of the bank.

As a technical assistance provider and as the agent responsible for funds disbursed under the CIDA project, Calmeadow must have been tempted to play the leading role in the project's implementation. To its credit, Calmeadow never walked down that road. It worked closely with Prodem to help develop a coherent plan for its future, but it let Prodem make the decisions and set the priorities. In this way, it acted as a sounding board, helping Prodem's leadership work through difficult scenarios and feel confident about its decisions.

"Calmeadow gave us unconditional support. They never said no, but would point out their concerns.... They trusted Prodem."

– Eduardo Bazoberry

Unlike Acción, Calmeadow had no pre-tested model or technology to offer Prodem. Instead, it offered a partnership in a search for new technologies that could respond to Prodem's challenges, namely how to make microfinance viable in rural areas. Calmeadow was open-minded and eager to listen and experiment. Its restraint and its facilitation of participatory decision-making processes had a major impact on the skills development of Prodem's senior management and their ability to encourage similar decision-making processes at other levels of their institution. As an example, Calmeadow played a major role in helping Prodem prepare for the creation of its FFP. It helped think through issues of capital structure, ownership, and the incorporation of savings, and it worked closely with Prodem to prepare financial projections and the memorandum for investors.

This kind of collaboration was possible because the overall process was governed by Prodem. Since Prodem made the decisions, believed in the path that was chosen and understood what needed to happen next, it could focus efficiently and effectively on implementing steps that would produce the results it desired. It could seek technical advice when it needed it, and when it made mistakes, it could learn from them. It did not have the option of blaming Calmeadow for a false step.

Box 3 : Two Models

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Prodem's experiences offer insight int
technical assistance models: the par
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Box 3 : Two Models of Technical Assistance

For institutions interested in supporting the capacity building process, Prodem's experiences offer insight into the advantages and disadvantages of two technical assistance models: the participatory model and the fee-for-service model.

In the fee-for-service model, an organization—be it a practitioner, technical assistance provider or a donor agency—identifies the need for a particular service. It then seeks either to obtain that service or to supply it, usually through a training course, conference or consultancy. A program is designed in response to the demand identified and is delivered for a fee.

Fee-for-service technical assistance can be provided quickly at a local or international level with well-defined parameters. Expected outcomes are clearly stated and their delivery is guaranteed, or the fee does not get paid. Fee-for-service contracts can be bid for on the open market, which facilitates transparency and keeps costs down. Prodem used this model to contract the services of Wiñay Pacha, a Bolivian software development company, to help it design its new MIS. The technical assistance provided was both efficient and effective in helping Prodem solve a specific problem.

The participatory model aims not to solve a specific problem, but rather, to build an institution's capacity to solve problems in general, or to accompany an institution in the process of moving from one phase of its development to the next. This type of technical assistance is complicated because it does not just transfer information about successful strategies; it develops an institution's ability to design and implement its own strategies. It is a longer-term process that requires more resources, a certain amount of chemistry, and a common set of values. The participatory model offers a return many times greater than that of the fee-for-service model, but it also involves higher risk.

Both technical assistance models have been proven useful, but it is the former that is most often applied because it is the easiest to implement, the least expensive, and has the simplest accounting. It is the type of technical assistance most readily available from consulting agencies, universities, and technical assistance providers, but it is limited in its ability to support institutional development. The participatory model is higher risk, more expensive, and more complicated to design, deliver and account for. Thus, it is much less available and much less frequently supported, but is an extremely valuable tool in building institutional capacity. Prodem was extremely fortunate to have obtained the support of technical assistance providers that believed in the importance and utility of both models and made use of them in their partnerships with the institution.

Calmeadow appropriately refers to its approach as "participatory technical assistance." It was an effective strategy, one which Prodem's leadership applauds for having significantly influenced its development. The two institutions were able to develop an open, communicative relationship that facilitated the transfer of technology and expertise to Prodem, and the transfer of information to Calmeadow. Since Calmeadow had fluid access to information and management, it was able to place control of the project in Prodem's hands without micromanaging and without fearing the accountability ramifications. It could also afford to be flexible, and even lobby for flexibility from donors like CIDA, because it understood the rationale behind Prodem's requests for change and believed that those changes would result in the more effective pursuit of the project's stated objectives.

Combining Contributions

Clearly, Prodem was fortunate to have the long-term support of two high-caliber technical assistance providers. It was also fortunate to have that support come from two institutions that knew how to collaborate. Calmeadow and Acción communicated well with each other, coordinated their activities, and were careful not to duplicate each other's efforts.

> *"Calmeadow accompanied Prodem throughout most of its institutional history, but Prodem has now outgrown that relationship."*
>
> *– Stefan Harpe, Calmeadow*

By paying as much attention to the context and the process through which knowledge was transferred as to the knowledge itself, Acción and Calmeadow were strategic partners for Prodem. The value of their approach is demonstrated by the extent to which Prodem, BancoSol and Prodem Oportunidad, FFP have outgrown their technical assistance relationships and are now able to stand on their own feet. Ultimately, Prodem's technical assistance providers have been most effective by slowly but surely working themselves out of the picture.

Financial Relationships

To launch and build two successful financial institutions, Prodem clearly needed allies who could supply it with the cash necessary to open its doors, develop its operations, and later, diversify and expand. This section briefly

explores how Prodem financed its
elements that made its different fin

Donor Support

From 1987 to 1999, Prodem
donations, which were used to cove
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institutions can only dream of this
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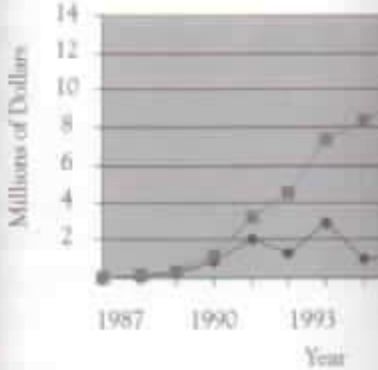
described below.

Figure 19: Summary of Donor Finan



Source: Computed by the author using P

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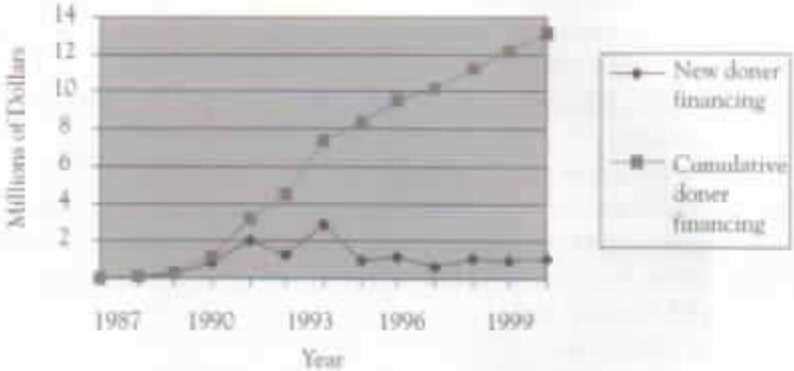
the cash necessary to open its doors,
sify and expand. This section briefly

explores how Prodem financed its operations, and highlights some of the elements that made its different financial relationships strategic.

Donor Support

From 1987 to 1999, Prodem received a total of $13.2 million in donations, which were used to cover operating expenses and to finance its loan portfolio and fixed asset purchases (see Figure 19). Most microfinance institutions can only dream of this kind of support. Certainly, the sheer quantity of resources that Prodem received influenced the results it was able to achieve, but the way in which those resources were made available also had an impact on the institution's development. The seven characteristics of donor support that Prodem found most beneficial are described below.

Figure 19: Summary of Donor Financing



Source: Computed by the author using Prodem statistics

1. The provision of seed capital. In September 1986, USAID/Bolivia approved a $560,000 package of support that financed Prodem's first 16 months of operations. The package included a $150,000 grant to establish the program, a $260,000 loan for establishing a revolving credit fund and a $150,000 grant for operating expenses from PL480 Title III funds. Prodem would not exist today were it not for this initial show of support and start up capital from USAID.

2. The investments in capacity building. Donors financed investments that required large upfront expenditures in infrastructure, the benefits of which could only be reaped over time. The management and communication seminars and the investments in computerized information systems are perhaps the two best examples of this type of support. The size and timing of these investments would have been

difficult, if not impossible for Prodem to finance on its own, even though the returns have been extraordinary.

3. The provision of assistance packages. Prodem's major donors provided packages of support that included technical assistance, loan capital, and grants to help cover operating expenses. This combination of support enhanced Prodem's ability to manage its growth by balancing the resources available for asset investments, operational expenses and institutional strengthening. It also facilitated the previously discussed contributions of Acción and Calmeadow. As non-profit organizations, these two institutions could not have participated in Prodem's development as actively as they did were it not for the financial support of USAID and CIDA, respectively.

4. Funding over a period of several years. Many microlending institutions suffer from limited, politically influenced and/or erratic donor funding. Prodem, for the most part, did not. This is a credit to its leadership's ability to keep donors engaged in supporting the institution, but it is also a credit to donors for making significant, multi-year commitments to Prodem. Their support made it possible for Prodem to focus its time and energy on improving and expanding its services rather than on fundraising.

5. The willingness to take calculated risks. Donors came through for Prodem during times of transition, when opportunities were many but outcomes were uncertain. CIDA and USAID financed COBANCO's efforts to create BancoSol. After the bank was successfully launched, CIDA stepped forward again to support Prodem's transformation into a rural lending institution.

6. Flexibility. Both USAID and CIDA found ways of being flexible when Prodem's institutional growth required it. USAID funded a large portion of Prodem's investment in BancoSol, which required the re-negotiation of three grants and one soft loan that had been made to Prodem and had not yet expired. CIDA ended up financing a large part of Prodem's FFP investment as part of its institutional strengthening project. To do so, however, budget categories had to be reassigned and disbursements sped up to meet Prodem's fast-paced timeline. If USAID and CIDA had not found ways to be flexible, Prodem's institutional development would have suffered.

7. Minimal bureaucracy. In most cases, Prodem's donor relationships had a human face, and that face belonged to a "doer" not a bureaucrat. According to Prodem, it made a huge difference to be able to work with people like Robert Anderson, Paul Chambers, Karl Leonard, John Owens, Rich Rosenberg, Gabriela Santa Cruz, Steve Smith and Lisa Valenzuela.

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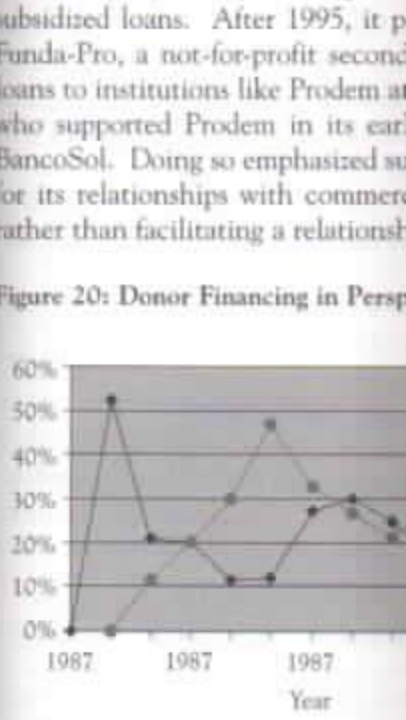
Figure 20: Donor Financing in Persp



Source: Computed by the author using P

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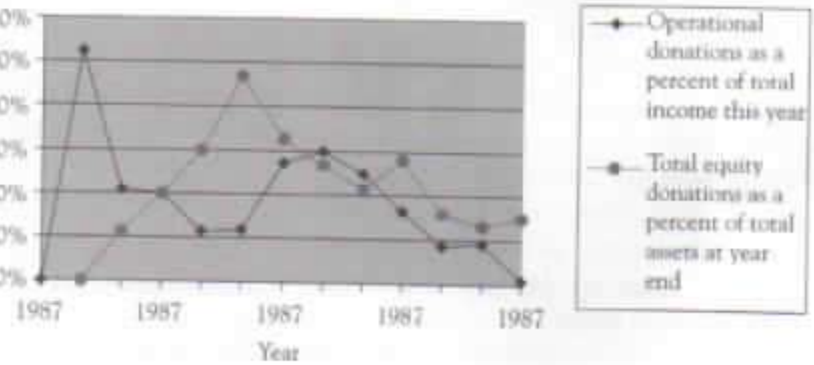
These individuals understood what Prodem wanted to do, they supported it, and they went out of their way to create a supportive environment within their respective bureaucracies.

Prodem prospered because it had the resources necessary to build capacity – both the human resources and the financial resources. Donors played a very important role in enabling Prodem to access both. They also encouraged Prodem in its efforts to make that access sustainable. USAID, for example, encouraged Prodem's gradual transition to financial self-sufficiency by slowly shifting the terms of its support from grants to subsidized loans. After 1995, it provided its support to Prodem through Funda-Pro, a not-for-profit second-tier lending institution that provided loans to institutions like Prodem at commercial rates. Many of the donors who supported Prodem in its early years also supported the spin off of BancoSol. Doing so emphasized sustainability and helped prepare Prodem for its relationships with commercial, private sector lending institutions rather than facilitating a relationship of dependency.

Figure 20: Donor Financing in Perspective[illegible]



Source: Computed by the author using Prodem statistics.

Figure 19 illustrated that donations to Prodem remained quite steady over time in dollar terms, but Figure 20 shows that the relative impact of those funds decreased over time. By 1999, operational donations represented just one percent of total income for the year. Figure 20 shows another interesting trend. By the end of 1999, the percentage of total

[illegible] Operational donations are defined as donations received by Prodem to help cover operational expenses. Equity donations are defined as donations received by Prodem to finance its loan portfolio or the purchase of assets. Total income is defined as financial income + operational donations + other income.

assets being financed by donations was a mere 15 percent. This means that Prodem was leveraging its donated funds more than six times by the end of that year. This understates the true impact of the donated equity funds, however, since the funds donated during Prodem's earlier years were also used to finance the creation of BancoSol. If one considers the total assets of both Prodem and BancoSol at the end of 2000, $122 million, then donors have actually leveraged their funds 28 times.

Accessing Capital

Prodem's initial capital came from two sources. Private Bolivian investors contributed 12.5 percent of the total and USAID provided 87.5 percent in grants and local currency loans.[64] Donors financed much of Prodem's early growth, but with an average annual growth rate of 133 percent between 1988 and 1991, it quickly became necessary for Prodem to seek other sources of financing as well. Its lack of options for accessing capital as a non-profit foundation was a major factor leading to the creation of BancoSol.

> *"We may be forging for the first time in human history the way to attack poverty with a tool large enough to be successful: the capital markets."*
>
> – *Michael Chu, former President of Acción*[63]

As predicted, BancoSol had easier access to capital than Prodem. By the end of 1994, loans from public entities accounted for only 2 percent of its total assets; deposits accounted for 66 percent, and loans from private entities accounted for 16 percent.[65] With this increased access to funds, BancoSol was able to continue the rapid growth trajectory initiated by Prodem. In just over five years, its portfolio topped $50 million.

After BancoSol was launched, Prodem found itself in many ways back where it had started in 1987. True, it had built a solid reputation, but it had also taken on a very risky new mandate and it was still a non-governmental, non-profit organization. The only entities willing to support Prodem in its initial efforts to reach rural microentrepreneurs were donors.

Of course, once Prodem had opened a dozen branches and those branches began to grow, its need for capital once again outpaced what it could access directly from donors. In 1996, it nearly failed to meet its

[63] Quoted by Lisa Genasci, in "Alms and the Man," *Boston Magazine*, July 1998.

[64] Bolivian investors included five individuals (Fernando Illanes, Carlos Iturralde, Fernando Romero, Luis Siles, Gonzalo Sanchez de Lozada) and four companies businesses (CEPB, Inermaco-Matreq, Comsur and Estalsa).

[65] Gonzalez-Vega, et al., "BancoSol," 13.

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and investment managers understo

Figure 21: Distribution of Financi

	1993	1994
Commercial banks	0	0
Inter-American Development Bank	500	455
Funda-Pro	0	442
Other entities *	0	0
TOTAL	500	897

Source: Prodem Statistics

Almost immediately, Prodem be
financial entities increased dramati

*Included in this category are Acción Int
(CAF), Calvert Investment Fund, Fondo d
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ada) and four companies businesses (CEPB.

disbursement schedule due to lack of liquidity. Since its plan to raise capital by selling branches to BancoSol had broken down, Prodem made two important moves in 1997. First, it decided to prepare for the possible conversion of its rural lending program into a private financial fund (FFP), and second, it hired Marcelo Maella as its new National Finance and Administration Manager. Maella came to Prodem from the Office of the Superintendent of Banks and Financial Institutions, where he had been intimately involved with the creation of the legislation under which private financial funds are licensed and regulated. Maella brought talent, skill, credibility and connections to Prodem's drive for financial sustainability. Together, he and Victor Céspedes, Prodem's Assistant Finance & Administration Manager, developed a short, medium and long-term financing strategy for the institution and then went to work building relationships with potential investors. They presented Prodem's future plans complete with financial projections; they demonstrated the institution's past performance; they explained that Prodem was already operating within the superintendent's norms for a regulated financial institution. They made Prodem's case clearly and in a language bankers and investment managers understood.

"With Victor and Marcelo I feel like I have two tigers talking to the banks… yeah they're more expensive, but they earn their pay; they're worth it."

- Eduardo Bazoberry

Figure 21: Distribution of Financial Obligations ($000s)

	1993	1994	1995	1996	1997	1998	1999
Commercial banks	0	0	0	0	3,000	7,354	3,131
Inter-American Development Bank	500	455	433	412	398	379	357
Funda-Pro	0	442	999	1,833	5,940	7,000	4,375
Other entities [*]	0	0	0	0	1,121	1,121	1,799
TOTAL	500	897	1,432	2,245	10,459	15,854	9,663

Source: Prodem Statistics

Almost immediately, Prodem began to see results. Its liabilities with financial entities increased dramatically from 1996 to 1997, largely due to

[*] Included in this category are Acción International, Andean Development Corporation (CAF), Calvert Investment Fund, Fondo de Desarrollo al Sistema Financiero y Apoyo al Sector Productivo (FONDESIF), Latin American Challenge Investment Fund, and Triodos Doen Investment Fund.

loans from Funda-Pro, a second-tier lending institution, and a $3 million commercial loan from a local bank, which Prodem secured using its BancoSol shares as a guarantee. Prodem also obtained a total of $1.5 million in financing from the Inter-American Development Bank, FONDESIF, the Andean Development Corporation, and Acción. In 1999, it succeeded in obtaining a commercial loan using its own loan portfolio as a guarantee. It also secured financing from other private sources, such as the Latin American Challenge Investment Fund, the Calvert Investment Fund, the Triodos Doen Investment Fund and the Andean Development Corporation.

In 2000, Prodem Oportunidad, FFP was successfully launched and the institution transformed its asset and liability management in much the same way as BancoSol did in 1992. As shown in the pie chart comparison presented in Figure 23 and Figure 22, 58 percent of the FFP's assets were being financed by deposits by the end of 2000, 25 percent by loan obligations and 15 percent by equity. This restructuring of liabilities, particularly through the capture of savings, enabled the FFP to lower its average cost of funds from 11.3% to 9.7 percent in just one year.

Figure 23: Sources of Financing, December 1999

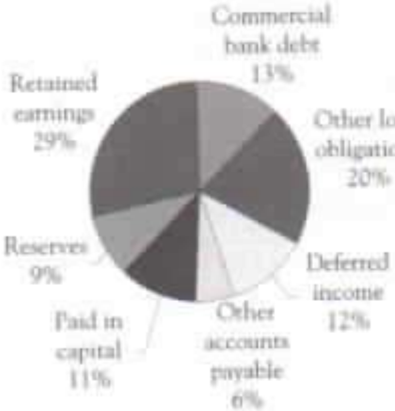
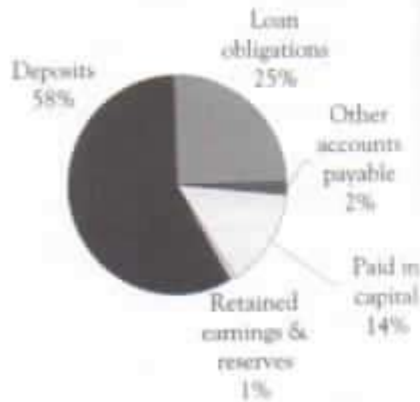


Figure 22: Sources of Financing, December 2000



The FFP also has plans, which are supported by the IDB and FOMIN, to issue up to $5 million in bonds on the local stock exchange without a government guarantee. Prodem has been excited about these plans since 1999 because the bond issue would be the first of its kind by a financial institution in Bolivia, but it is waiting for conditions to improve before

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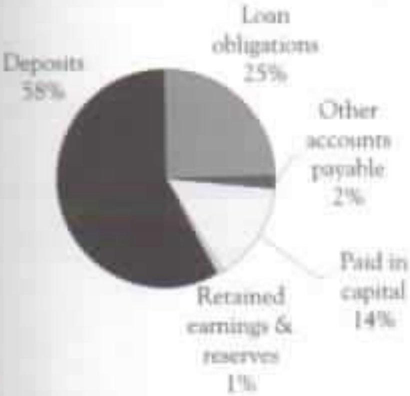

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moving ahead. With a stagnant portfolio, a stagnant economy and a general unwillingness by investors to go anywhere near the Bolivian banking industry, now would not be the most propitious time to proceed.

Ownership

At the end of 1987, Prodem managed a gross portfolio of $158,421, the majority of which was financed by local private investors, with the remainder being financed by USAID donations. Since it was constituted as a non-profit foundation, no one really owned Prodem, but one could argue that the local private investors controlled it.

When BancoSol was created in 1992, it was able to attract a more diverse array of investors. This was partly because Prodem had already demonstrated the viability of urban microlending in Bolivia, and partly because the new bank was to be a for-profit, regulated financial institution with real shareholder participation. By the end of its first year of operations, Prodem held only 29 percent of the bank's equity, foreign private investors held 27 percent, local private investors held 25 percent, and international non-profit organizations held 19 percent (see Figure 24). This balance of power among the different types of investors was generally seen to be a positive characteristic of the bank's ownership structure. Prodem did not control the bank, but neither did anyone else.

Figure 24: Comparison of Equity Composition during First Year of Operations

	Prodem Foundation (Dec 1987) %	BancoSol (Dec 1992) %	Prodem Oportunidad, FFP (Dec 2000) %
Donated capital	43	0	0
Prodem Foundation	N/A	29	72
Local private investors	57	25	28
International NGOs[a]	0	19	0
Foreign private investors[aa]	0	27	0

Source: Prodem and BancoSol statistics

When Prodem Oportunidad, FFP was launched, however, it chose an equity composition that was distinct from that of both the Prodem Foundation and BancoSol in their first years of operation. At the end of

[a] Includes Acción International, Calmeadow Foundation, FUNDES, and SIDI

[aa] At the end of 1992, BancoSol's only foreign private investor was the Inter-American Investment Corporation

2000, the Foundation held 72 percent of the FFP's shares, and local private investors held the remaining 28 percent. The non-balanced nature of this equity structure is notable, especially when contrast with that of BancoSol. Prodem was criticized for taking this position, but it asserts that maintaining control during the FFP's early years of consolidation is critical. It lost control too early in BancoSol's development and felt that the institution and its clients suffered as a result. It plans to pass control of the FFP into the hands of private investors, but will do so over time, and it will focus on passing control to local, rather than international players. One of Prodem's main criticisms of BancoSol's ownership evolution is that it resulted in decreasing participation by local investors. By 1999, only 10% of the bank's equity was controlled by private domestic concerns and some of these were businesses rather than individual investors.

As early as its first Offering Memorandum, completed in February 1998, Prodem anticipated the participation of various types of investors, through a multi-phased process that would keep control of the institution in Bolivian hands. In the first phase, the Prodem Foundation would retain the vast majority of the shares with the remainder being owned by private Bolivian investors. In the second phase, the Foundation would reduce its participation in the FFP to approximately 30 percent by transferring some of its shares to institutional investors such as the CAF and the BID, by selling some shares to other private investors, and by transferring approximately 10 percent of the total shares to employees of the FFP in the form of a pension fund. This second phase is taking effect in 2001, although the Foundation has decided not to lower its participation below 51 percent for the time being. In the third stage, institutional investors are supposed to sell their shares to individuals in the private sector.

Prodem continues to be committed to this phased-in process and admits to being picky about who it allows to invest in the FFP. It asserts that such a policy is necessary to ensure that the FFP remains committed to its mission.

Relationship Management

Not unlike its relationships with its employees, clients, and technical assistance providers, Prodem's financial relationships were effective, in part, because of the way they were managed by Prodem. Clearly, one of the institution's strengths was the formation and maintenance of relationships. To conclude this section, it is worth summarizing three important aspects of Prodem's relationship management that contributed to its success.

First, Prodem understood
importance of dialogue, and no
communication. Naturally, it
important that Prodem kept its d
informed of its progress, that it publ
its results in international forums, t
gave regular information session
potential borrowers, etc. It was
important, however, that Prodem ac
its donors, its potential investors,
difference that Prodem spoke the va
hold these conversations—Ayn
accounting, finance, bureaucratese,
an effort to hold conversations in
sharing of information.

Second, Prodem made use of
strengthen external alliances. This
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that came together to found Proder
included representatives from th
Bolivian political community, the
and the microfinance technical con
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"These guys delivered when they said they would deliver."

– Paul Chambers, CIDA

First, Prodem understood the importance of dialogue, and not just communication. Naturally, it was important that Prodem kept its donors informed of its progress, that it publicized its results in international forums, that it gave regular information sessions for potential borrowers, etc. It was also important, however, that Prodem accepted and responded to feedback from its donors, its potential investors, its staff and its clients. It made a difference that Prodem spoke the variety of different languages necessary to hold these conversations—Aymara, Quechua, Spanish, English, accounting, finance, bureaucratese, and body language—and that it made an effort to hold conversations in contexts that were conducive to the sharing of information.

Second, Prodem made use of its internal alliances to create and strengthen external alliances. This was particularly relevant in its quest to access capital. As mentioned previously, the individuals and institutions that came together to found Prodem, and who ultimately sat on its board, included representatives from the Bolivian business community, the Bolivian political community, the North American business community and the microfinance technical community. Without this mix of different voices within the institution, it would have been difficult for Prodem to speak the languages, let alone get in the doors, of some of the institutions controlling the capital. It bears repeating that had Prodem not had such a diverse and prestigious collection of players involved in its governance, its financial relationships would have been much more difficult to cement.

Third and finally, Prodem delivered what it said it would deliver. It may sound simple, but there are numerous reasons why institutions and individuals alike often have a hard time handing over the deliverable they promised by the time they promised and in the way they promised. Prodem gained respect and power within its relationships by disbursing loans when it said it would disburse, by collecting its loans on the day they were due, by paying its creditors on time, and by meeting its growth projections. The rapport it established within its relationships helped get its messages heard, but ultimately, it was Prodem's performance that won the support of its partners over time.

The Failed Merger

In general, Prodem was talented at building relationships and using those relationships to support its development. It attempted to forge a new kind of alliance in late 1998 through a merger with FIE, another Bolivian FFP. The merger made sense for both parties as a strategy for facing the increasingly competitive environment. Prodem and FIE were similar in size, they both had a non-profit background and had been in operation for a similar period of time. Prodem specialized in rural lending while FIE specialized in urban lending; FIE had an individual loan portfolio while Prodem had a largely solidarity group loan portfolio. Merging the two entities would have diversified the risk of both institutions and given the new entity the second largest market share in the industry next to BancoSol.

Yet, in September 2000, the merger failed, just as the two institutions were about to seal the deal. Why?

There was nothing particularly unusual about the fact that FIE and Prodem attempted to merge. The global mergers and acquisitions market has been steadily growing during the past three decades, reaching a total value of $3.4 trillion in 1999[**]. Increasingly, companies in a cross-section of industries have come to view mergers as a strategy for capturing economies of scale and scope, and for accessing new markets, products, technology and customers. Prodem and FIE pursued their merger for these reasons; they did so in a fairly typical manner, and ultimately, they achieved a fairly typical result.

When competition started to heat up in the Bolivian microfinance industry, microfinance institutions of all shapes and sizes started to think about their strategic options, one of which was consolidation. Both Prodem and FIE were among the institutions that began to put out feelers in mid-1998. After some preliminary informal conversations, Bazoberry called Pilar Ramirez, FIE's Executive Director, one day and said, "let's talk." He and Ramirez spoke, and the two talked independently with other institutions as well, including the largest FFP at the time, Caja Los Andes. In the end, FIE and Prodem decided to pursue an alliance with each other.

Late in the year, representatives of both institutions met to explore the possibility of a merger in more concrete terms. Prodem presented its objectives, strategic plans and philosophy. FIE presented its objectives, strategic plans and philosophy, and then the two institutions decided that their philosophies were compatible. They agreed on a shared vision of the

[**] Fay Hansen, "Global Mergers and Acquisitions Explode," Business Credit Magazine, (National Association of Credit Management, June 2000) 23-25.

future that involved taking the
creating a new FFP.

For approximately the next eig
analysis and due diligence to defin
the new FFP would be. They
methodology, management, huma
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Some thought FIE was crazy
Ramirez, FIE was more interested
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In late 1999, PWC moderated
and managers of both Prodem an
the merger. At the meeting, a S
presented, which illustrated the
strategic plan was discussed.
incentives surfaced. To simpl
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future that involved taking the best of each of their institutions and creating a new FFP.

For approximately the next eight months, Prodem and FIE engaged in analysis and due diligence to define what each institution's contribution to the new FFP would be. They looked at each other's technology, methodology, management, human resources, fixed assets, loan portfolio, liabilities, ownership and more. Eventually, the time came to put a value on the package that each side brought to the table and, as is typical in mergers, there were problems. Many mergers never get past this point because the parties involved cannot agree on a common valuation of the assets being brought to the table. In this case, Prodem and FIE decided to trust their common auditing company, Price Waterhouse Coopers (PWC), to come up with figures that were fair to both sides.

Based on the present value of the two institutions' contributions, PWC recommended a 56 percent (Prodem) to 44 percent (FIE) split in participation. Prodem was unhappy with this, arguing that the future value of its assets greatly exceeded the present value. Serious negotiations ensued, and eventually Prodem and FIE agreed on participation levels very near to those recommended by PWC: sixty percent Prodem and forty percent FIE, with Prodem's executive managers assuming the three top management positions in the new entity.

Some thought FIE was crazy to accept this deal, but according to Ramirez, FIE was more interested in the long-term success of the new FFP than it was in controlling the top management positions. It knew Bazoberry, Prudencio and Maella worked well together and formed a very competent team. Breaking up that team would not have been wise strategically, and it may have been a deal breaker for Prodem.

In late 1999, PWC moderated a meeting with the principal shareholders and managers of both Prodem and FIE to obtain preliminary approval for the merger. At the meeting, a SWOT analysis of the new institution was presented, which illustrated the merger's synergies and challenges, and a strategic plan was discussed. It was then that the problem of staff incentives surfaced. To simplify the issue, monetary incentives for individual loan officer performance were a major part of FIE's reward system, while such incentives at Prodem had been abandoned several years prior. It had been agreed during the due diligence that these kind of incentives would be phased out by the new institution, but FIE was concerned about what that might do to portfolio quality, particularly in the short term. Negotiators from Prodem and FIE had agreed that if more than 9 percent of the portfolio of either institution had to be written off by the new entity, the shareholders of the original institution would respond by covering the cost of the excess write-offs. This proposition looked dangerous to FIE's owners. As a show of good faith and to demonstrate its willingness to craft an effective new reward system for the new entity, Prodem agreed to eliminate the 9 percent condition and have the new institution assume all portfolio liability. It was the beginning of the year 2000, and it seemed the two institutions had finally reached an agreement.

The process of obtaining legal and regulatory approval for a merger then began. A name was chosen – Fondo Financiero Privado Prodem-FIE, and a timeline for the merger's implementation was submitted, together with a great deal of other paperwork, to the Superintendent of Banks and Financial Entities. In August 2000, Ramirez and Fernando Anker, Chair of Prodem Oportunidad, FFP, finally met with the Superintendent and received a green light to proceed with the merger. All that was left now was for the boards of the two FFPs to sign the legal document that would create the new entity.

As the date of the board meetings approached, Bazoberry decided to visit some of FIE's branches to introduce himself and his vision for the new institution, and to have a chance to discuss the future with loan officers and other branch staff. It was a characteristic move for Bazoberry, who often went to the field to interact with his employees, and he did so this time only after receiving Ramirez' consent. To everyone's surprise, the branch visits created quite a commotion, particularly around the issue of incentives. It seems Bazoberry made it clear that the new FFP would not be retaining the individual incentives reward system, and when loan officers heard this, they panicked.

"Seventy percent of all mergers and acquisitions fail."

– Alexandra Reed Lajoux

Perhaps Bazoberry was too aggressive, perhaps the loan officers overreacted, perhaps the whole thing could have been smoothed over if Ramirez had been able to get a hold of Bazoberry instead of having to resolve the issue through other parties. In any event, the issue was not smoothed over, and that is why the merger failed. The inability of the parties involved to resolve what could have been a simple miscommunication suggested the presence of deeper concerns. The incentive issue brought to the fore feelings of distrust and ill will that had been simmering below the surface, but had been suppressed throughout the negotiations by two management teams that had a great

Alexandra Reed Lajoux, "Do deals deliver on postmerger performance?" Mergers & Acquisitions, Sept-Oct, 1998.

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deal of respect for each other and sincerely wanted to make a marriage work between them.

The interaction of the various parties around the issue of incentives made everyone realize how difficult the day-to-day resolution of problems within the new institution might be. Neither side felt like it was getting political support from the other, and neither wanted to be in a relationship in which it would not be supported. Each institution thought the other was back-peddling. Ramirez felt she was being treated as a second-class citizen; Bazoberry thought he had been cut out of the loop.

"We both lost a fantastic opportunity."

– Pilar Ramirez, FIE

Ultimately, the Prodem-FIE merger failed for reasons that are very common in the business world: conflicts of culture and control. The merger made all the sense in the world from a technical perspective, but culturally and politically, it did not. Prodem was powerful, aggressive, and was accustomed to getting its own way. FIE, in many respects, considered itself the underdog and was accustomed to forging its own untraditional path. While FIE was looking for a marriage of equals, Prodem expected to be able to place its cultural footprint on the new FFP.

It is extremely difficult to merge two different cultures. Some specialists in mergers and acquisitions claim it is impossible; one party always ends up dominating the other. FIE sensed this dominating trend in its relationship with Prodem, and feared that the merger would not be a marriage of equals but rather, an acquisition. It was one of the reasons for its backing out of the deal.

The second reason was control. Cultural issues alone would not have broken the deal, nor would the technical issue of incentives. But when the boards of the two institutions had to make a decision about the merger in a highly conflictual environment, the mutual trust that had been holding the two sides delicately together was overpowered by a desire to test how much control each would be able to exercise in the new institution. The tension between owners of the two FFPs was not new. There were disagreements between them relatively early in the negotiations, which actually led to FIE's principal shareholder divesting. The Prodem Foundation also ended up buying out some of Prodem Oportunidad's private investors in order to secure a larger participation in the new FFP. Again, it was an issue of control.

Whether the conflict served as a wake up call for board members who had never been committed to the merger, or whether it simply shook up a precariously stacked house of cards, the battle for control proved to be the merger's fatal blow. The previously cooperative spirit of negotiations degenerated into a series of arguments over who was right and whose way was best. The idea of creating a new FFP that would combine the best of what Prodem and FIE had to offer became impossible. Ramirez submitted a letter to Anker on September 1, 2000 announcing the decision by FIE's board not to proceed with the merger due to "differences between the institutions with respect to human resource policies, credit methodology and institutional culture."[71]

The negotiating teams from both FIE and Prodem were devastated by the merger's collapse. They had put two years of time, energy and financial resources into the merger's development, only to have it fail. They were frustrated that their irreconcilable differences were not recognized sooner, although they agreed that it was better to recognize their incompatibility late in the process than never. If synergies would not be created, or if the costs of creating them would outweigh the benefits, the merger was not worth pursuing, no matter how beautiful the idea may have looked in theory and no matter how determined individuals on both sides were to make it succeed.

[71] Pilar Ramirez, letter to Fernando Anker, September 1, 2000.

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"Prodem has embraced change
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–Martin Connell, Exe

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CONCLUSION

"Prodem has embraced change with vision and entrepreneurial energy. It has been a true pioneer in the field of global microfinance."

–Martin Connell, Executive Director, Calmeadow

Reflecting on the previous chapters, it becomes clear that there is no easy answer to the question, "Why was Prodem so successful?" Numerous factors combined to make Prodem a strong institution, principally, a powerful corporate culture, visionary leadership, supportive donor and technical assistance relationships, favorable macroeconomic conditions, appropriate technology, the careful selection and development of employees, and the adoption of participatory processes that linked microentrepreneurs to loan officers to system designers to executives. Everyone was made responsible for creating a superior institution.

It is important that Prodem and its supporters considered the requirements of institution building early on, and set out not only to develop operational capabilities, but also to ensure that those capabilities could be maintained over time. The attention Prodem paid to processes, to performance monitoring, to continuous improvement, and to the development of analytical skills at various levels of the institution helped it to prevent existing capabilities from being eroded and to recognize when new capabilities needed to be developed. This has been key to Prodem's successful management of change, and it will continue to be critical to the sustainability of Prodem Oportunidad.

Given that the true test of any capacity building process is its ability to generate results in the long term, this document concludes with some observations and closing comments about the future prospects of the Prodem Foundation and the two financial institutions that it created. Where are they headed, how likely are they to succeed, and why?

The Prodem Foundation

The Prodem Foundation has considerable resources with which to pursue its new agenda. After nearly fifteen years of operation, it has a wealth of experience building institutions and relationships that facilitate economic development. It knows a great deal about the microenterprise environment in Bolivia, as well as the needs and desires of microentrepreneurs in that environment. Many of the talented and influential individuals who governed the institution in 1987 continue to guide it today. On the ground, its young and determined team of professionals share the same, powerful vision that inspired the institution's creation a decade and a half ago, but they now work from a sizeable endowment base.

Of course, financial resources alone do not guarantee Prodem's continued success, but they certainly give it a head start. Also important is the Foundation's ongoing commitment to partnership with microentrepreneurs. This will continue to be the principal means through which the Foundation identifies new development initiatives and makes them effective in the long-term. Prodem's success in building and maintaining such partnerships in the past makes one optimistic about its ability to do so in the future.

The Foundation's many years of experience could also work against it, however. As a mature institution, it may find it difficult to maintain the dynamism, creativity and innovation for which BancoSol and Prodem Oportunidad became famous, particularly since the majority of its leaders have left to work with the spin-off institutions. It was difficult for Prodem to rebuild momentum after the creation of BancoSol, and it will no doubt be even more difficult to rebuild momentum in today's unfavorable environment.

A second potential limitation is the Foundation's dependence on the success of BancoSol and Prodem Oportunidad for its own sustainability. Nearly fifty percent of its endowment is tied up in equity investments in those two institutions. If either one gets into serious trouble, the Foundation will suffer. Even if they perform moderately well, which will be a challenge over the short term, the Foundation will have limited access to its funds until the securities market develops in Bolivia, and until the public's confidence in the banking industry improves. Conversely, if BancoSol and Prodem Oportunidad perform extremely well in the future, the Foundation could live off the dividends generated by its investments, although it may have to scale back its activities or leverage its limited funds with other donated resources in order to pursue a larger-scale program. In

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Banco Solidario, S.A.

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Table 26: BancoSol Performance

Total assets
Total portfolio
Number of borrowers
Administrative expenses as a percentage of average total assets
Administrative expenses as a percentage of average gross loan portfolio

Sources: Koenigsfest, "BancoSol," 5; *Boletín*
Bulletin, April 2001, 44-50.

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the meantime, the Prodem Foundation has several million dollars with which to experiment. Only time will tell if its experiments can yield more paradigm-breaking strategies for supporting microentrepreneurs' development.

Banco Solidario, S.A.

BancoSol's ability to deliver long-term results has already been proven. It has been operating profitably for nearly ten years and, for the most part, continues to serve its traditional clientele.[72] With less than two percent of the banking system's assets, BancoSol served 28 percent of the system's clients in 2000. It rated high in terms of solvency, risk, liquidity and capital adequacy when compared with other banks in the Bolivian financial system, and has been ranked among the top three banks in the country since 1997.[73]

Like most Bolivian financial institutions, BancoSol contracted during the last two years. The size of its portfolio and client base, and the number of its branches and employees have all decreased, yet the bank continues to be the country's largest in terms of the number of clients served and it succeeded in generating a slight profit in 2000 when more than fifty percent of the country's financial institutions recorded a loss. According to the international credit rating agency, Fitch Ratings, BancoSol is in a solid position within Bolivia's banking industry.[74] Among its Latin American peers, it is still a performance leader (see Table 26).

Table 26: BancoSol Performance Comparison, December 2000

	BancoSol	Average of 9 large Latin American MFIs
Total assets	91,899,000	34,108,155
Total portfolio	77,802,000	27,175,166
Number of borrowers	60,976	29,730
Administrative expenses as a percentage of average total assets	12.8%	14.5%
Administrative expenses as a percentage of average gross loan portfolio	16.4%	18.0%

Sources: *Koenigsfest, "BancoSol," 5; Boletin Microfinanzas Dec 2000, 60, MicroBanking Bulletin, April 2001, 44-50.*

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[72] A study by members of the Economics and Sociology Department of Ohio State University suggests that although BancoSol's average loan size has risen over time, this was due to its clients' growth, rather than to mission drift. See Gonzalez-Vega, et al., "BancoSol," 21.

[73] Kurt Koenigsfest, "BancoSol and Financing for Women Entrepreneurs," BancoSol Internal Paper 2001) 4.

[74] Koenigsfest, "BancoSol" 4; and Fitch IBCA, Duff & Phelps, "Calificación Local de Riesgo al 30 de Septiembre de 2000" (La Paz, December 28, 2000).

Of course, BancoSol must deal with the financial, economic and political risks inherent in the current Bolivian environment. On July 1, 2001, a group of small borrowers strapped dynamite to their chests and took hostages at the Superintendent's office demanding loan forgiveness and lower interest rates. Competition from the FFPs, including Prodem Oportunidad, is increasing. The bank's inability to attract private investors, particularly domestic investors, is a topic of much conversation within Bolivia's microfinance industry and, no doubt, internationally as well.

BancoSol's environment is undeniably challenging, but with its experience, reputation, political clout, loyal client base, and international connections, there is little doubt that it will find ways of dealing with those challenges. Its institutional shareholders are some of the most respected organizations in microfinance today, and given the bank's role as a flagship institution within the microfinance industry, they will have both financial and professional incentives to see it succeed. The conservatism of BancoSol's strategy in the late 1990s, together with the recent efficiency gains generated by new management, make it easy to be optimistic about the bank's future viability, even in a risky environment.

The more interesting questions with respect to BancoSol's future concern the direction it will take and the route it will choose to get there. To what extent will it continue defining itself as a microenterprise bank? Will it take risks on innovative new products or will it simply copy the innovations of others once they are brought to the market without having to absorb the research and development costs? If it does this, how will it differentiate itself from other financial service providers? Does it need to differentiate itself, or can it offer a competitive service to existing clients and make a business out of helping them grow? Can BancoSol prove that both the social and commercial objectives of microfinance are sustainable in a competitive environment? Or will social objectives have to be sacrificed for survival?

Prodem Oportunidad, FFP

Prodem Oportunidad, FFP, having been in operation for just over a year, has yet to prove its longevity. It is demonstrating, however, the ability to manage change, and this will be critical to its long-term sustainability. In 2000, it kept its delinquency level lower than that of any other bank or private financial fund; it introduced several new products; it complied with the reporting requirements for regulated financial institutions; it even recorded a small profit.

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By the end of its first year, Prodem Oportunidad's institutional strengths were clear. It had the largest branch network of any financial institution in the country, and its business strategy was designed to make the most of that network.[illegible] It had some of the most talented and experienced employees in the industry. For the time being, it had a technological advantage over most financial institutions because of its customized computer information systems and its introduction of the digital smart card. Perhaps most importantly for the long-term, it had a tradition of value-based operations and a set of core principles that guided and inspired its activities.

The FFP's weaknesses were also readily apparent as the year 2000 drew to a close. The institution was notably less efficient than its competitors and was as vulnerable as any financial institution to the risky political and economic environment. Its employees were becoming discouraged by the impact of the external environment on clients and by gaps that were emerging between the FFP's traditional values and its actions on a day-to-day basis.

Prodem recognized these weaknesses and began responding almost immediately, at times in innovative ways. It designed a new incentive system based on year-end profit sharing and an employee stock fund. It is diversifying into non-banking industries and is offering some of its staff the opportunity to work with those spun-off businesses. It is lowering its financial costs by mobilizing savings. It is also taking an active role in strengthening ASOFIN, an association of specialized microfinance institutions, to serve as an industry body through which Prodem and others can lobby the government and the Superintendent of Banks and Financial Entities on important political, economic and regulatory issues. It is hoped that ASOFIN will also provide a mechanism through which microfinance institutions can organize a response to the small debtor protests. It is a new kind of alliance that could prove strategic.

Although efficiency issues will remain a priority for Prodem in the near future, the FFP's immediate challenge is likely to be alignment. With a new business strategy now in place, Prodem will need to rally the different parts of its organization behind it. It will need to weave a better fit between its unique vision of participatory capitalism, its corporate goals, its culture, its reward system, its organizational structure, and its human resource

[illegible] In terms of absolute number of branches, Banco Mercantil has a larger branch network than Prodem Oportunidad (59 compared to 52), but Prodem has branches in more municipalities than Banco Mercantil, which has 28 of its branches concentrated in three of the country's main cities. See SBEF, Anuario Estadistico 2000 cuadro no. 109.

development, so that each element supports the others and there is coherence among the elements as a whole.

The challenge of alignment will be key in another respect, and that is in terms of aligning social and business objectives. This kind of alignment is not easy, but the challenge offers a great opportunity for Prodem Oportunidad, and is the principal reason for optimism with respect to the FFP's future. In the past, Prodem's competitive advantage was generated by its value-based culture, in particular, its development-oriented mission and its trust-based relationships. More recently, the institution developed a competitive advantage based on geography and technological innovation. While strategic, this competitive advantage will be difficult to maintain, since competitors will rapidly copy any product innovations and introduce them at a lower cost. The FFP will have to constantly innovate to compete effectively.

If, however, the FFP implements a business strategy that embraces both a value-based culture and technological innovation, it could develop a competitive advantage that competitors would find difficult to replicate. As John Dalla Costa argues in his recent book, *The Ethical Imperative*, businesses like Prodem Oportunidad do not have to maintain a value-based approach simply for altruistic reasons; they can do so because it makes business sense. By building a trusted and trusting organization, they can increase customer and employee loyalty, attract strategic partnerships, foster a creative environment, and produce more responsive, higher quality services.[38]

Since trust is the basis of all financial transactions, building a competitive advantage that is based on trusting relationships makes particular sense in the financial services industry. In the past, Prodem developed such relationships through personal contact and excellent communication, by delivering what it said it would deliver, and by delighting customers with new opportunities. Although the FFP's relationships are becoming less personal, the institution is still capable of building trust through its culture, by continuing to innovate and deliver on its promises, by being creative about how it involves existing and potential clients in its processes, and by continuously looking for ways to improve the quality of its service.

There is little doubt that Prodem Oportunidad, FFP has built sufficient institutional capacity to survive in the future, barring some national economic or financial meltdown. But whether it merely survives or thrives will depend on its ability to align the various parts of its operation

[38] See John Dalla Costa, The Ethical Imperative (Toronto: HarperCollins 1998) 204.

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strategically and to maintain that alignment in a constantly changing environment. In sum, Prodem's story demonstrates that the process of institutional capacity building is, first and foremost, a process. It must be recognized as such from the very beginning, and then supported with long-term vision, discipline and commitment. This approach to capacity building is part of what made Prodem so successful, and it will surely continue to influence the institution's ability to exercise innovative leadership in the future.

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About the author:

Cheryl Frankiewicz is an independent consultant working in the field of microfinance. She has lived and worked in Bolivia, Indonesia, Peru and Canada, where she recently completed a final review of the Calmeadow Metrofund, one of North America's largest microloan funds. Ms. Frankiewicz holds a bachelor's degree from Wellesley College and a master's degree in international affairs from Columbia University. She is currently an M.B.A. candidate at the University of Ottawa.

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