The Rise and Fall of Corposol:

Lessons Learned from the Challenges of Managing Growth

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MICROENTERPRISE BEST PRACTICES

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by

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EXECUTIVE SUMMARY

The Colombian nongovernmental organization (NGO) Corposol, founded as Actuar Bogotá in 1988 to support the development of microentrepreneurs through providing credit, training, and other services, pursued a growth trajectory that offers important lessons for the microfinance industry. During its initial years of operation, Corposol rapidly reached a significant number of clients, generated corresponding growth in lending, and began to diversify its products and services to fulfill a broader range of client needs. In combination, these factors represented important strides toward fulfilling the institution's social mission, as well as its objective of reaching a self-sustainable scale of operations. Subsequently, however, some of Corposol's growth-generation strategies proved to have negative implications for its quality of lending. Moreover, it became apparent that Corposol had not developed, at a comparable pace, its organizational capacity to support its growth. Over time, resulting diseconomies of scale destabilized operations and contributed to the eventual demise of all but one component of the institution.[1] This study analyzes Corposol's growth generation and the inadequacy of its organizational development relative to that growth. More specifically, the present study examines critical aspects of Corposol's staff development, organizational design, and institutional culture that affected the institution's trajectory to extract lessons about aspects of organizational development that are critical to sustainable growth and management.

Corposol's problems began gradually but compounded over time. The mandate for growth was an operating premise that existed from Corposol's inception. At different moments in the institution's tenure, that mandate could be attributed to Corposol's desire to achieve significant social outreach, its need to demonstrate an ability to attract donors or establish credibility with the financial sector, its attempt to achieve sustainable scale, and its aspiration for public recognition of its success. Even in Corposol's early years, as the institution began to penetrate its first markets and expand geographically, these motives combined to drive operational parameters that promoted growth without sufficient attention to lending quality. Such parameters included increasingly ambitious performance objectives, defined by variables that prioritized lending growth over quality, and severe penalties for employees who did not meet those objectives. Together, these parameters weakened lending standards and field staff practices.

This trend was exacerbated by the strains that expansion placed on field staff development. Branch-level operations relied on experienced personnel to train incoming loan officers in lending practices and oversee the application of these practices. Although much of this process was informal, it allowed for effective quality control on a contained scale. Yet, the efficacy of such mechanisms was overwhelmed by the pace of both staff growth and geographic expansion. When experienced staff were no longer sufficient in numbers to play a central role in developing new staff, the system lacked an alternative structure or parameters to support and control lending consistency.

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[1] The Corposol holding company ceased operations in September 1996, with the exception of Finansol, a subsidiary that was recapitalized and continues to pursue basic lending operations.

Later, Corposol pursued expansion of scope as well as scale, seeking to leverage further its existing administrative structure and extend the institutional mission via a diversification of client services. In less than a year-and-a-half, from late 1992 to mid-1994, Corposol branched out from its basic credit and training programs to include rural operations via Agrosol, regulated financial intermediation via Finansol, retail merchandise distribution via Mercasol, and technical support for home or shop construction or improvement via Construsol. These elements constituted what became the Corposol holding company, designed to maximize economies of scale and scope for the group.[2] Unfortunately, this interesting concept was not developed in a way that achieved those objectives. Both the approach to and preparation for the changes, as well as the structure of the holding company itself, later proved problematic, for the following reasons:

- Corposol management underestimated the new challenges associated with growth via untested methodologies relative to those it faced during its previous expansion. The pace of diversification precluded adequate analysis of demand, financial feasibility, and cost/benefit as well as pilot and adjustment of new operational methodologies. The launch of initiatives, some of which required large up-front investments, without such a development phase set the stage for precarious financial and operational results.

- The importance of integrated planning to manage the process of change, as well as preparation of the organization to work with the new products, was also insufficiently recognized. Minimal training of loan officers and branch managers; underdeveloped information systems; and deficient policies, procedures, and other support structures all added to operational strain, as unprepared staff, driven by ambitious performance objectives, were asked to manage unfamiliar products with insufficient tools and support. This combination of factors, together with the policy of encouraging growth via multiple simultaneous loans to the same client, in the absence of adequate support or control, resulted in overindebtedness of many clients, which further contributed to declining portfolio quality.

- Structurally, functional redundancy and the complications of integral management precluded the anticipated economies of scale. Although the management of the holding company strove to maximize the results of the whole, favorable outcomes did not always occur for all of the holding's distinct parts. Cross-subsidization to support weaker elements with stronger ones is not uncommon or necessarily problematic. Yet, in the case of Corposol, such practices made it difficult to evaluate the true financial health of the for-profit entities of the holding company, a factor that clouded early detection of problems. Worse, subjecting Finansol, a regulated commercial finance company (CFC), to ultimate oversight and management authority of the NGO Corposol created destabilizing conflicts of standards and interests. Ultimately, structural dependency between the components became another weakness, as the burgeoning crisis in Corposol left no element untouched.

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[2] The holding was later expanded to include *Soluciones Urbanas* and was projected to develop Fundasol and Segursol.

At the same time, the ongoing expansion led to insufficient attention to critical support. When the aforementioned elements began to take their toll on operations, much attention was devoted to addressing the holding company's financial crisis, without adequate attention to the critical role of the related human resources crisis. The declining sufficiency of staff training and oversight, the dilution of organizational values as a function of the overriding growth mandate, and the resulting deterioration of staff morale and motivation took a toll on lending quality and, later, volume. Although internal human resources staff and hired consultants identified these weaknesses, initiatives designed in response were never accorded sufficient management support to address these weaknesses comprehensively.

Beyond the lack of attention to support elements, over time, Corposol's leadership perpetuated an unbalanced organization with structural weaknesses that contributed to its ultimate downfall. From Corposol's inception, its founder and president had centralized control and authority, which, especially at the outset, allowed rapid propulsion of the institution's growth. This concentration of control gradually became a debilitating factor. Elements ranging from uneven middle management formation to an insufficiently independent governance structure led to a lack of checks and balances that might otherwise have helped curb less prudent initiatives or allowed for an earlier response to negative outcomes.

The combination of these factors produced the following series of implications:

- A gradual deterioration of field operations, which led to methodological deviation, poor lending practices, and fraud, all of which contributed to the erosion of portfolio quality, a fatal driver of Corposol's financial crisis.

- A degeneration of holding company management, as the intoxication with success and, later, the self-imposed pressure to perpetuate that success led to increasingly ambitious and imprudent decision making. Such decisions were exacerbated by conflicts of interest, deficient professional integrity, and a lack of checks and balances, which resulted in mismanagement and fraudulent practices.

- The bankruptcy of Corposol, as the beleaguered organization reached the point at which operational income and donations could no longer sustain the cost of Mercasol losses, Finansol provisions for at-risk portfolio, and repayment of liabilities incurred to permit the functioning of the organization.

- A significant ongoing operational challenge for Finansol, the only surviving holding company element, to rebuild lending practices, field staff motivation, and the market perception required to achieve a financially self-sustainable scale of operations.[3]

[3] Finansol's name was changed to Finamericá in late 1997 as part of this process.

Potential interpretations of Corposol's experience that are disproved by this analysis are as follows:

- The experience of Corposol should not cast doubt on the viability of the microfinance model. Other successful institutions have demonstrated that lending methodologies to avoid risk, effective operational procedures to support decentralized lending decisions, and the combination of efficiency and scale to permit financial self-sustainability can all be achieved. This experience shows what an institution needs to put in place to function given those parameters and the consequences of not doing so proactively, in anticipation of the strains of growth.

- This experience should not lead one to conclude that the concepts of product diversification and management via a holding company are bad ideas. On the contrary, Corposol's problems were not at the conceptual level, but in how these concepts were structured, set up, and managed, which reiterates the importance of organizational sufficiency to support a new initiative.

- Finally, a strong chord throughout this study is the role that characteristics of Corposol's leadership played in driving growth and in inhibiting the development of aspects of the organization to help manage that growth. Although Corposol's domineering leadership played a critical role in the organization's downfall, this was not the only problem; the inadequacy of structural checks and balances within the organization and at the board level also permitted negative aspects to have the impact they did. Even with the same leadership, Corposol's deterioration might have been contained had the organization had a stronger structure.

With hindsight, it appears that much of what Corposol suffered might have been avoided had the appropriate attention been paid to preparing the organization to support and control its growth. It is hoped that other institutions, beginning with those that were closely involved with Corposol, such as ACCION, may benefit from the lessons gleaned from the challenges experienced by a pioneer in the industry.

CHAPTER ONE: INTRODUCTION

PURPOSE

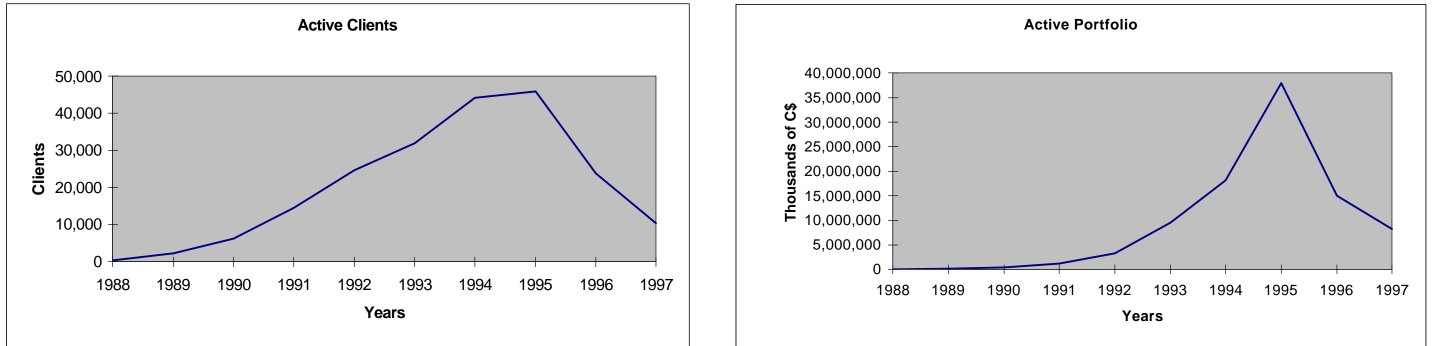
Growth in client base, in lending, and in other services has long been a measure of success for microfinance institutions. Growth in number of clients resulting from outreach and in lending to accommodate clients' needs fulfills a social mission common to the industry. At the same time, growth in the scale of services an institution provides relative to the administrative structure required to support those services is a critical variable in achieving operational efficiency and, therefore, financial self-sustainability. As such, growth — to further social goals and realize economies of scale — is a primary objective for many institutions in the field. Generating growth is only part of the equation, however. The experience of the Colombian nongovernmental organization (NGO) Corposol suggests that when an institution grows faster than does its capacity to manage that growth, *dis*-economies of scale result as the stability of the institution is put at risk.

During its existence, Corposol, which was founded in 1988 as Actuar Bogotá, pursued extraordinary growth. In the early 1990s, the organization purchased Finansol, a commercial finance company, and thereafter augmented its growth by diversifying its products and services.[1] From 1988 through 1994, the organization gained a significant number of clients at a rate surpassing that of many of its Latin American peers — growth that was accompanied by dramatic portfolio expansion (see Figures 1 and 2). Moreover, beyond outreach in lending, the Corposol holding company was conceived to meet clients' needs with a variety of new services intended to further the institution's development mission. The scale of Corposol's achievements made it an example to other practitioners during the 1988-1994 period. The organization's precipitous growth, however, culminated in crisis, as poor portfolio quality and large sales and inventory losses associated with Mercasol, a retail venture of the Corposol holding company, surfaced in 1995. Related impacts proved Corposol's financial and operational condition to be a house of cards.

Although various factors contributed to Corposol's crisis, some factors derived from structural weaknesses in the organization's development and the insufficiency of systems put in place to support that development. Many of those weaknesses began as mere fissures in Corposol's foundation, imperceptible to external observers. Yet, under the pressures of growth, the fissures became cracks and enlarged to the point at which they could no longer support healthy operations.

[1] Actuar Famiempresas (Corporación de Acción por Bogotá) changed its name to Corposol (Corporación de Acción Solidaria) on May 12, 1994, in keeping with its desire to unify in the public mind the many client services offered in pursuit of the institution's goal of integral development (discussed below). For clarity, the organization will be referred to here as Corposol. Annex A delineates the institution's changes in legal structure and name.

Figure 1 and Figure 2: Growth and Decline in Clients and Portfolio



Corposol's unfortunate demise in 1996 imposed a tremendous cost on its clients (though depositors were protected), staff, investors, and funders. Beyond their concern about the impact on these groups, some have questioned whether Corposol's experience has implications for the future of the industry itself. Although the challenges Corposol encountered could be common to many organizations, most of these problems can be avoided. As such, this case study seeks to analyze the characteristics of Corposol's organizational development that affected its growth and management over time. More specifically, the study examines Corposol's processes for staff development, its organizational design, and its institutional culture amidst the challenges posed by its growth. The lessons extracted from Corposol's experience may offer insights to other practitioners and contribute to their effective management of growth.

FIELD RESEARCH METHODOLOGY AND CONTEXTUAL LIMITATIONS

The author used a combination of sources in an attempt to thoroughly describe Corposol's organizational development. All sources of information are described below.

First, the author conducted approximately 40 interviews with former Corposol staff, current Finansol staff, and third parties who observed or participated in the institution's development via technical or governance-related roles. This sample reflected people who had worked at or come into contact with nearly all levels and areas of the organization during different phases of its development. These people *were* the organization; they produced its growth, experienced the process of staff development and organizational design, and recalled the impact of Corposol's institutional culture in many ways that were never documented. As such, they offered a wealth of information to aid our understanding of Corposol's internal dynamics.

Second, the author also analyzed historic and current operational and financial documents that reflect the strategies Corposol employed at each stage of its development. The team used these documents to confirm interpretations offered by interviewees in personal accounts.

Note, however, that this study represents an attempt to document and analyze historic information about an organization that largely no longer exists.[2] This implies that many departments whose activities are the subject of this inquiry have been disbanded, their functions discontinued or transformed, their documentation stored, and their employees dismissed. This situation is further complicated by the ongoing investigation by Colombian authorities into Corposol's bankruptcy. Together, these circumstances limited the team's access to some information sources, precluded more comprehensive analyses in some areas, and may have shaped the information shared in interviews, as outlined below.

Data

Because of the bankruptcy investigation, Corposol's computer databases had been sequestered by Colombian authorities at the time of this study. These include accounting, personnel and payroll, and historic portfolio data.[3] Without access to such databases, certain statistical analyses of operations are impossible.[4] Consequently, the study team was forced to rely on information available only in printed documents — information that was generally summarized in predetermined formats without sufficient disaggregation to permit analysis of many specific inquiries. Unfortunately, some hard-copy files were inaccessible or incomplete, for reasons discussed below.[5]

Documentation

Dissolution of certain aspects of Corposol's operations was not clean-cut or immediate. Rather, employees submitted their files as they left, and, at the time, the files were not

[2] The only exception being Finansol, the commercial finance company whose portfolio was formally separated from the Corposol holding company in June 1996, prior to Corposol's shutting its doors in September of that year.

[3] Corposol's data are the only historic information on the holding company prior to 1994, as Corposol was the continuation of the original organization, Actuar Bogotá. From 1994 on, Corposol continued to manage functions such as payroll for most components of the holding. Thus, alternative sources are at best incomplete and pertain only to recent years.

[4] With sufficient information, analyses could include, for example, load management and self-sufficiency by branch in geographic expansion, salary structure inequities or employee turnover, productivity and delinquency trends by loan officer, client repayment as a function of the number of loans held, among many others that would support evaluation of the variables targeted by this study.

[5] Another challenge related to the use of hard-copy sources of information was that different sources sometimes reflected inconsistent figures. Although an attempt was made throughout this report to cite the most reliable source possible in such cases, several factors cloud any potentially definitive reference. Nomenclature and report structures changed frequently, making it difficult to verify that line items on different reports reflected identical information. At the same time, once the holding company was created, uncertainty arose in interpreting which components should be included in any given aggregation. Moreover, staff involved with statistics processing explained that "adjustment" of numbers was a common practice. As such, it is impossible to be certain of how to interpret each discrepancy.

catalogued or organized.[6] Thereafter, any such files became part of the documentation submitted to the agents hired to liquidate Corposol. Turnover among those agents has further complicated the organization of documents submitted. Consequently, at the time of the field research for this study, there appeared to be no unified inventory of files, which, combined with the restricted access mandated by the liquidation proceedings and the problem of missing documentation, made reference to historical information less than comprehensive.[7] Thus, documents that would have provided concrete information under normal circumstances were not always available for this study.

People

Uncertainty or insecurity surrounding sensitive issues still under investigation may have shaped the information some interviewees shared. Nevertheless, interviewees seemed to welcome an opportunity to share their experiences to help other institutions avoid Corposol's experience. Finally, some accounts of the same events differed between interviewees, possibly because some aspects of the organization's structure precluded fluid information exchange. Although each of these aspects complicated the research process, difficulties were mediated by ACCION International's affiliate relationship with Corposol, dating from the latter's creation as Actuar Bogotá.[8] This relationship generated historic institutional "memory" that might otherwise have disappeared. It also yielded intact files produced during technical assistance efforts for the years when ACCION was a member of the board of Actuar Bogotá and, later, Finansol.[9] Most important, ACCION's years of involvement gained interviewers the trust of interviewees, permitting a depth of personal analysis that otherwise could not have occurred. Thus, despite the above caveats, this study is believed to reflect the most complete discussion of these issues possible at this time.

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[6] This occurred over several months in 1996, as some employees resigned when they recognized Corposol's crisis, some were fired when Corposol realized the need to streamline its payroll, and others stayed until Corposol's final closing in hopes of receiving their severance pay. For this reason, many of the people interviewed do not have their own historic files, other than selected documents they may have retained.

[7] As of July 1997, Colombian authorities had been searching for 10 months for accounting details on Corposol's management during 1996. Cited in "Desvían Fondos de Ayuda Internacional," G. Ignacio Gomez and Norbey Quevedo, *El Espectador,* p. 4A. Santa Fe de Bogotá, July 23, 1997.

[8] ACCION International's relationship with Corposol is discussed in Chapter Six.

[9] Note, however, that information distributed to the board has a different focus than that used in operational processes, and thus often lacks the level of detail that would have permitted certain analyses.

CHAPTER TWO: BACKGROUND

Analysis of the organizational development factors that affected Corposol's growth management can be best understood in the context of the institution's trajectory. This chapter will summarize that trajectory.

Some of the first Actuar programs dedicated to microcredit and training in Colombia were born in the aftermath of the volcanic eruption of Nevado del Ruiz on November 13, 1985. That eruption caused an estimated 21,000 deaths, wiped out the livelihood of 60,000 inhabitants, and induced an avalanche of efforts and funds directed toward emergency relief and rehabilitation assistance. Much of this assistance was provided as grants, which offered immediate but temporary relief. In search of a more sustainable solution, the Actuar programs in Tolima and Caldas were created in 1986 to provide the poor and marginalized with tools that would enable them to increase their income-generating capacity and quality of life: credit, training, and technical assistance.[10]

Those first efforts were initiated by eminent members of the Colombian business communities in the regions noted. However, these business leaders also operated businesses in Bogotá, which soon made them realize that although significant numbers of people had been displaced and were destitute as a result of the volcanic eruption, those numbers were dwarfed by the estimated two million to three million poor and marginalized residents of Santa Fe de Bogotá. This led to the idea of Actuar Bogotá, founded in the summer of 1988 to provide financial services and training to an informal sector that employed more than 50 percent of the country's economically active population. Operations began with the solidarity lending methodology applied by many institutions in the ACCION International network, facilitated by corresponding technical assistance.

Experience showed no shortage of demand for credit and training by the microentrepreneurs of Bogotá's informal sector, as reflected in Figures 1 and 2 in the previous chapter. As a result, both the organization and its operations grew rapidly. At the height of lending by the end of 1995, the institution served nearly 50,000 active clients whose loans generated an active portfolio of more than US$38 million, with 703 employees working out of 24 offices.[11, 12]

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[10] These programs had learned from the original Actuar program, Actuar Antioquia (begun in 1983), of the entrepreneurial drive of survivors in the informal economy. In essence, these programs were founded on faith in the intrinsic capacity of microentrepreneurs to generate growth and income from capital and technical assistance if given that opportunity. This intrinsic capacity offered the key for an economic solution to the immediate physical disaster as well as the entrenched structural poverty of the larger Colombian economy. In addition, this approach was more sustainable than grant forms of assistance.

[11] For reasons noted above, the figures presented here and throughout this study are approximate, as differing sources indicate numbers that vary somewhat above and below these numbers. Number of active clients is a particularly problematic variable; interviewees explained that it did not always reflect rigorous accounting for client desertion. Ad hoc comparisons between field- and institutional-level data for this and other variables suggest the possibility of double counting and other variance. Absent more detailed field documentation, however, it is impossible to quantify fully the impact of this potential tendency.

[12] Corresponding growth in personnel and infrastructure will be discussed in detail in Chapter Four.

From the beginning, Corposol funded its lending and operations with a combination of donations and bank borrowings backed by various types of guarantees from its board members, ACCION International's Bridge Fund, FUNDES, and others. By 1992, Corposol was reaching the limits of the capital it could access via its existing funding mechanisms. Management and the board began to explore the possibility of transforming Corposol into a full financial intermediary to permit the institution to meet its future funding needs via direct capital market access and capture of public deposits.

First, a feasibility study was conducted on establishing a bank similar to the BancoSol model in Bolivia.[13] Although the study showed the BancoSol model to be a viable alternative, creating such a bank would have required C$10,146 million (US$13.7 million) in capital at the time. In April and May 1993, a change in banking regulations offered as an alternative model the *compañía de financiamiento comercial* (commercial finance company, or CFC), which required only C$1,902 million (US$2.6 million) in capital.[14] At the same time, a willingness in the CFC market to sell allowed Corposol to save time, logistics, and money by purchasing an existing CFC rather than create a new one.[15] After a second feasibility study and an assessment of alternatives, Corposol acquired Financiera Fenix, S.A., which became Finansol, S.A., in November 1993.[16]

This acquisition was the first of many significant changes in Corposol's organizational structure. Up to that point, the only modulation of Corposol's original urban program had been its extension of credit, training, and technical assistance services into rural markets through the AgroActuar (later Agrosol) program, initiated in October 1992. Although rural lending required some methodological adjustments, Agrosol benefited from the experience of established programs such as the FINCA village banking model in Costa Rica. Essentially, therefore, Agrosol was in the same primary business as Corposol, and its creation largely represented a geographic expansion for the organization. Corposol had also broadened its training services from providing merely a precredit orientation in credit management to offering more in-depth business management training in 1991 and expanded technical

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[13] This first feasibility study, performed by the consulting firm COINFIN (Consultoría Instituciones Financieras) was completed in December 1992.

[14] Decree #633 of the *Ley Estatuto Orgánico de Bancos* allowed CFCs for the first time to make loans with terms of less than one year, an essential condition for Corposol, whose average loan term at that time was fewer than six months.

[15] This occurred when *Ley 35* of *Decreto Reglementario #913* created a new type of CFC that was permitted to perform both leasing and credit operations, functions that previously had required two separate entities to implement. This put established CFCs on the market, as owners with two institutions no longer needed both.

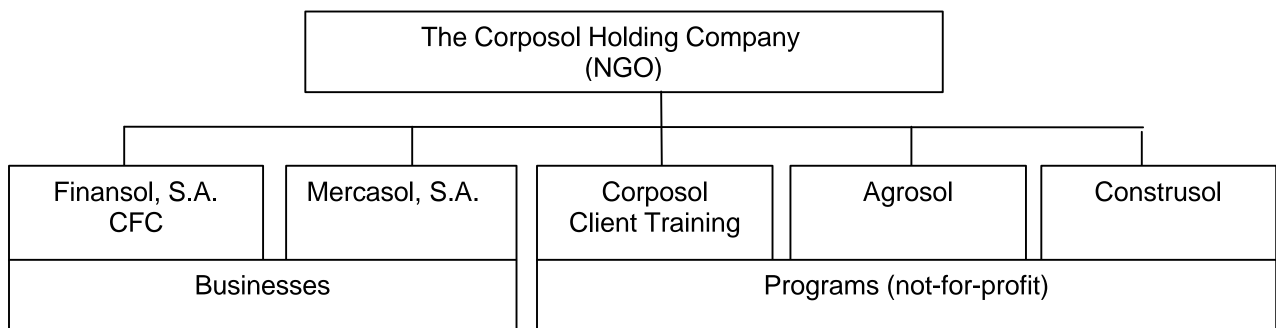
[16] Corposol purchased 76.6 percent of Financiera Fenix; the remaining shares went to Corposol's employee fund, the Corporación Financiera de Desarrollo (a once-governmental entity that was privatized in 1993, with shareholders including the Interamerican Investment Corporation and the Interamerican Development Bank), and Corposol's top two managers. Immediately thereafter, Finansol began a capitalization process that incorporated the issuance of additional shares to allow for investment by entities including ACCION International, the Calmeadow Foundation, FUNDES, and a number of private Colombian investors (by and large the same ones who had helped found Corposol, plus the top management and board of Finansol). This reduced Corposol's participation, but only to 63 percent, allowing it to retain effective control. As such, most of the board consisted of Corposol supporters, weighting the structure of governance. During some periods, ACCION International held the only independent seat on the board.

training in 1993. However, this change also could be considered as development consistent with the original business.

These were only the initial elements of Corposol's goal of "integral" development. Beyond helping clients increase their income, Corposol wanted to strengthen the link between improved economic status and improved quality of life. Management believed that the poor are at a disadvantage in that their poverty makes quality-of-life improvements more difficult or expensive than for other people. This logic argued, for example, that the purchase of raw materials for production or goods for sale is more expensive for the poor because of their small scale (which necessitates purchasing in small quantities from expensive intermediaries) and their location in marginal areas (which tends to increase transport costs). This hypothesis can be extended to parallels in their ability to attain quality housing, health care, and education. As such, one goal of Corposol's integral development was to help balance the laws of supply and demand to allow the market to function as equally for the poor of Bogotá as for society as a whole for price, quality, availability, volume, and other factors.

With this ambitious vision, in May 1994, Actuar Bogota legally became the Corposol holding company, as depicted in Figure 3 below.[17]

Figure 3: The Corposol Holding Company



Within this structure, the components had the following roles:

- The Corposol holding company, which retained Actuar Bogotá's NGO status, was to provide strategic leadership, administrative support, public relations, and general coordination for the group. Corposol also retained the field operation (loan officers, branches, and so forth), as it was to serve as a locus for the provision of services for all branches of the holding company. Corposol was a controlling interest in the two for-profit entities, Finansol and Mercasol, and acted as a fundraiser for development for the not-for-profit programs.

[17] The fleshing out of some of these elements occurred over time; for example, the first Construsol loans were issued in December 1994. Nonetheless, the conceptual scope of the holding company existed from its creation in May 1994.

- Finansol, S.A., a private CFC supervised by the Superintendency of Banks, served as the financial intermediary of the group. As such, it was to issue the loans for each component with credit operations and fund its operations via capital markets. As the only regulated entity, Finansol was also accountable for the quality of the aggregate portfolio of the group. Moreover, because Finansol was a private institution responsible to its shareholders, part of its mission was to become profitable.

- Mercasol, S.A., a commercial retailer, was created to help bring small clients closer to producers by operating with institutional economies of scale (which allow leverage with suppliers in purchasing) and passing those savings on to clients while allowing them to purchase in small quantities.[18] This service was made available to clients with stores, restaurants, or similar businesses that use or resell food and other consumer goods.[19] Such clients were offered automatic credit lines for purchasing in Mercasol outlets. As with Finansol, Mercasol was intended to become a profitable operation.[20]

- Corposol client training was an ongoing program that reflected management's belief that clients were more likely to be able to increase their income and quality of life if taught to better manage their businesses; improve the nature, quality, or diversification of their production or sales; and better direct the utilization of their income.[21] Any credit client was automatically charged a training fee that was tied to the disbursement of their loans. Although clients were not obligated to attend training courses (and could opt to send family members or employees), they still were charged the fee. Although this component of the holding company was defined as not-for-profit, it did generate significant income for Corposol.[22, 23]

- Agrosol, as noted above, was the rural branch for Corposol credit, training, and technical assistance services. Although Agrosol credits were issued by Finansol, Agrosol remained not-for-profit.

- Construsol was designed to support clients in making physical improvements to their homes or businesses. Based on the belief that many clients were already pursuing such improvements inefficiently because of minimal or sporadic net income, Construsol was to provide the technical assistance of architects, engineers, and lawyers to help clients plan and execute construction projects within their budgets. Clients could take out a

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[18] Mercasol's prices were to be set with respect to the market. Management emphasized that its goal was not to undercut other providers, distort the market, or subsidize clients' operations, but rather to help stabilize the market's tendency toward price volatility in this sector.

[19] To ensure that Mercasol would not compete with its own clients and distort the market, clients with unrelated business activities were not allowed access to Mercasol services.

[20] At its height, Mercasol had several retail outlets, but its sales volume never reached break-even. Thus, in addition to receiving start-up grants from CODESPA, a development institution of the Spanish government, Mercasol's operations were heavily subsidized by Corposol until the retailer was closed in early 1996.

[21] Note that this reflects only one of the viewpoints held by successful microfinance institutions. Some successful institutions whose managers believe in the ability of microentrepreneurs to develop on their own given the opportunity would consider this approach paternalistic.

[22] In part for this reason, course offerings later expanded far beyond business management principles to include activities ranging from crafts to music lessons.

[23] In 1994, for example, training fees represented 28 percent of Corposol's operational income.

> Construsol loan (issued by Finansol) to fund their improvement projects, in addition to their other existing loans for working capital or fixed assets. Clients were also charged an additional technical assistance fee for the services they received. It was hoped that Construsol, a not-for-profit, could become financially self-sustainable and be spun off as a private institution.[24]

Corposol had also envisioned further expanding the holding company to include Fundasol, to pursue education (and take over Corposol's training activities); Segursol, to offer clients affordable and reliable insurance; and Saludsol, to meet the health care needs of the sector.

Many of Corposol's ideas were conceptually interesting in terms of their potential contribution to development of microentrepreneurs and the industry. During 1994 and early 1995, Corposol also continued to demonstrate strong growth in clients and lending and a portfolio with reasonably controlled levels of delinquency. All of these factors may have glossed over concerns about the pace of Corposol's diversification of services into untested waters or the ultimate implications of such rapid growth for the stability of Finansol's portfolio.[25, 26]

In retrospect, some actions could have been served as early warning signals, such as Finansol's failure to generate sufficient revenues to cover the cost of its operations, provisions, and inflationary adjustments, or the insufficient rotation of merchandise in Mercasol outlets. Yet, these warnings were obfuscated or justified by contextual excuses such as the status of Colombia's economy, an unfortunately timed mandate by the superintendency to limit lending growth by regulated financial institutions, and the normal start-up costs of new initiatives.

In May 1995, after months of negotiating permission from Corposol, ACCION International performed a CAMEL diagnostic of "Gruposol."[27, 28] Although in aggregate the institution scored relatively well, the CAMEL team noted a series of weaknesses reflecting a deterioration of operations between 1992 and 1994.[29] From the organizational side, the CAMEL team expressed concern about the ambiguity caused by dividing management of the

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[24] Corposol had envisioned a model of incubation for new ventures to be spun off as they became profitable. Unfortunately, holding company operations never reached that stage of development.

[25] With hindsight, some have interpreted the scale of this venture as evidence of "empire building" by Corposol's president. Characteristics of his leadership style and their impact on the operations of the holding company are further discussed in Chapter Three.

[26] Such implications included a gradual deterioration of lending standards applied in the field operation, as the rate of growth in staff precluded sufficient training or oversight, while compliance with institutional performance objectives created an impetus for shortcuts in procedures and excessive lending to existing clients. Such tendencies led to the erosion of lending quality, which became a slippery slope in Corposol.

[27] CAMEL is a quality-control tool applied by ACCION staff to evaluate the status of network affiliates. This diagnostic comprises quantitative and qualitative analysis of *C*apital sufficiency, *A*sset quality, *M*anagement, *E*fficiency, and *L*iquidity.

[28] "Gruposol" was sometimes used to refer collectively to the holding company, to differentiate between using the name "Corposol" to describe the holding company and using it to describe the components of the holding specific to Corposol (that is, those excluding Finansol and Mercasol).

[29] Data were provided through December 1994, which precluded an assessment of subsequent deterioration that had occurred by the first half of 1995.

credit function between Corposol and Finansol; ineffective information flow in the organization, which influenced the efficacy of management and decision making; and a very high rate of employee turnover, a costly symptom of broader organizational problems. The team also identified deterioration in asset quality (measured by delinquent portfolio as a percentage of active portfolio and as a percentage of equity), efficiency (measured in terms of both operational costs and physical productivity of loan officers), and profitability, even though Corposol's average loan balance had more than doubled during the same period. At the same time, the CAMEL team noted uncertainty about the consistency of certain statistics.[30]

These concerns later proved to represent only the tip of the iceberg. In mid-1995, it became apparent that extensive refinancing and the sale of poor-quality portfolio from Finansol to Corposol had been pursued, temporarily disguising problems while deferring required provisions and write-offs of the same bad loans. Despite the concerns of third parties, Corposol continued to conduct business. In May, the holding company was expanded with the purchase of *Soluciones Urbanas* ("Urban Solutions"), a low-income-housing developer. Although management explained the venture as a potential means to serve clients, given Corposol's already precarious situation, the logic and timing of such an investment could be considered questionable. Worse, an in-depth operational diagnostic conducted in the third quarter of 1995 identified hidden delinquency in the Agrosol portfolio that was previously nonexistent because of Agrosol's independent, manual accounting system. Countless other problems also were emerging in field- and back-office operations.[31] Further, the fragility of performance statistics presented to donors and the public gradually became apparent as cross-referenced sources revealed inconsistencies. Together, the continued portfolio deterioration (which led to increasing provisioning costs for Finansol), Mercasol's ongoing losses, and Corposol's managerial decision making (which included desperate cash-flow management, real estate speculation, and costly forced expansion of the field operation in hopes of augmenting income generation) produced a financial crisis that came to a head in early 1996.

In late 1995, Finansol management decided to return to basic lending via proven methodologies, halting the credit operations of Mercasol, Construsol, and Agrosol. Although the performance of the loans issued under the new policies was healthy and showed the wisdom of the decisions made, this success was dwarfed by the larger problems of the organization. In February 1996, the superintendency halted new lending by Finansol out of concern for its continued deterioration in asset quality.[32] By May 1996, Finansol's continued losses had eroded its equity to less than half of what it had been at the start of that fiscal year, providing grounds for intervention by the superintendency. Such action was avoided only

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[30] Any diagnostic instrument is only as good as the information to which it is applied. Good faith and a clean audit may have precluded further digging into certain data provided.

[31] The diagnostic was conducted by the respected banking sector consultant who assumed charge of Finansol after the exodus of its first president.

[32] Though this left loan officers free to dedicate their efforts to loan recuperation, curtailing lending growth limited Finansol's ability to offset losses via increased income generation. At the same time, clients who realized new loans would not be granted may have been less likely to repay their existing loans. This trend can spread through markets, further complicating the recuperation of delinquent portfolio and thus adding to provisioning costs.

with an extensive recapitalization campaign.[33] At the same time, during the first half of 1996, Corposol's cash-flow crisis rendered it unable to meet payroll obligations, much less repay its creditors.[34] In June 1996, the portfolios of Corposol and Finansol were officially separated in an attempt to insulate Finansol's operations from the larger carnage of Corposol. The two institutions were completely severed when Corposol ceded its shares in Finansol to creditor banks whose loans to Corposol had been collateralized by those shares. In September 1996, Corposol officially closed its doors.

Despite the collapse of Corposol, Finansol, S.A., continued to function after the intensive recapitalization, and the institution was allowed to resume new lending in October 1996. Clear of the immediate crisis, Finansol's next task was to continue the turnaround of its extensive field operation and its position in the market. Further diagnoses of various aspects of Finansol's operations were conducted and plans developed for systematic resolution of remaining weaknesses. Much progress was made, and Finansol's operating results improved steadily.[35]

Finansol's recovery demonstrates that changing the way a large field operation functions is inherently an extended process. The deep roots of employees' work habits and motivations as well as clients' repayment culture, to name a few factors, make it difficult to rebuild quickly. More generally, Corposol's experience further emphasizes the importance of structuring an organization so that problems can be identified and resolved before they reach the scale they did in the present case. It is hoped that the following analysis can lend insights to this challenge.

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[33] The capitalization efforts, spearheaded by ACCION International in close collaboration with Profund (a microfinance investment fund), FUNDES, and Calmeadow, raised C$3,500 million (approximately US$3.5 million) by August 1996 and another C$7,500 million (about US$2.6 million) by the end of that year. Later, an additional C$2,000 million (roughly US$1.5 million) was raised in July 1997, for a total of about US$12.5 million. Investors included the *Instituto de Fomento Industrial* (Colombia's second-tier development bank), the *Fondo Nacional de Garantías* (Colombia's National Guarantee Fund), Citibank-Colombia, the *Fundación Social* (a leading Colombian nonprofit foundation), ACCION's Latin American Network, other Colombian microfinance institutions, and the TRIODOS Bank of Holland.

[34] By March, all field personnel managed by Corposol had been formally transferred to Finansol, resolving both an element of Corposol's payments crisis and the structural problem of divided responsibility for the credit process, which had been outstanding since the creation of Finansol.

[35] Loan officers have been further trained in credit analysis; client zones redefined to enhance field staff productivity; the payroll streamlined to reduce operating costs; unprofitable urban and rural branches closed, the security of information systems and the efficiency of back-office operations improved; a large, unproductive piece of real estate sold; and a new line of credit to small businesses via the FUNDES methodology added, broadening the market served and helping build the portfolio.

CHAPTER THREE: GROWTH-GENERATION STRATEGIES

Although aggregate statistics would suggest that growth is growth, experience has proven that not all growth in microlending has the same implications for an organization and its clients. Each aspect of an organization's commercial operations may affect the volume and quality of growth generated and the institutional capacity to manage it. Such was the case in Corposol's expansion.

The sources of Corposol's growth can be disaggregated in a variety of manners. Management pursued different approaches to expansion of the original business during each phase of the organization's development, including intensive market penetration, productivity management, extensive geographic expansion, and product diversification. At the same time, certain underlying operational premises affecting the nature of performance were constant throughout these phases. This chapter will summarize each of the strategies contributing to Corposol's growth and their positive and negative effects over time.

INITIAL MARKET PENETRATION

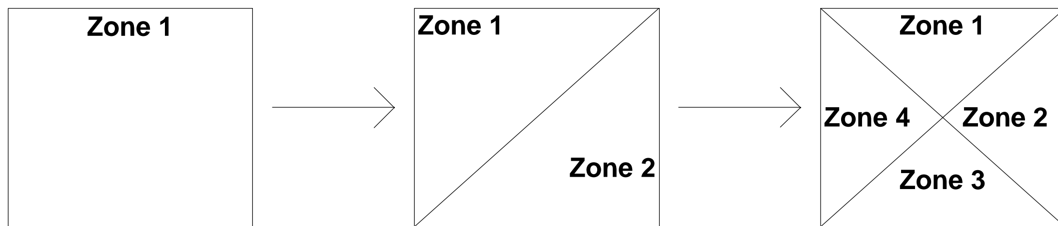
For more than a year (1988-1989), Corposol loan officers conducted their operations from a single central office. The organization began with a field staff of three plus their leader and visited clients in zones identified as the poorest in Bogotá.

Staff who were loan officers at that time and immediately thereafter explained in interviews that the process of zone selection and development was carefully controlled up until 1990. They would visit a zone to diagnose client needs and potential demand, which they would do by evaluating the market(s) and meeting with leaders from the community. Staff was not permitted to initiate lending in zones with limited demand; a minimum standard of 20 established solidarity groups (groups of four to seven self-selected microentrepreneurs formed as a unit for borrowing) was required to start operations. The founder himself would attend and address community organizational gatherings to fully assess the viability of the potential market.

Zones were carefully delineated for each loan officer in an attempt to concentrate the officers' efforts geographically, thus minimizing the potential productivity lost in traveling between clients. The zones started out large (see Figure 4); as loan officers surpassed a benchmark number of groups (discussed in Chapter Four) and additional loan officers were hired, the zones were subdivided and clients were transferred from saturated loan officers to newcomers.[36] This system was intended to generate zones that would diminish in size while enjoying increased client concentration over time, allowing perpetual gains in productivity.

[36] In principle, the clients of the experienced loan officer in question were designated for transfer or retention according to their geographic location. In practice, when not supervised, the process of client transfer could be less than equitable and efficient, as existing loan officers might prefer to keep or transfer certain clients for reasons other than geography (that is, the clients' repayment tendencies).

Figure 4: The Subdivision of Loans



To optimize the positive effects of concentrated zone management and achieve the maximum possible market penetration, zone control was strict in the early years. The first loan officers recall that even if clients were lining up for loans in surrounding neighborhoods, officers were not permitted to lend to them until existing zones could be considered saturated. When asked to define "saturated," one loan officer explained that it meant the point at which every viable microentrepreneur had a loan.[37] Case in point: at the end of 1989, Corposol still operated in only two zones of Bogotá, despite the city's vast potential market.

These initial strategies were those Corposol controlled most, and they generated relatively healthy growth until the zone management mechanism hit a snag. Two complications surfaced as early as 1991. When zones first began to reach effective saturation, management resisted field staff requests for new territory, expressing the belief that they should be able to further develop existing markets.[38] Restricted to existing zones and forced to generate new clients to comply with performance requirements, many loan officers began to resort to one of two responses. Some, in the attempt to follow the mandate within existing zones, began to bend lending requirements to find more eligible clients in saturated markets. Others sought clients where they could find them, ignoring zone boundaries. Each of these tendencies was problematic in its own right – the former directly augmented credit quality risk, while the latter created geographic dispersion, which over time takes its toll either in productivity or in lending quality, as loan officers have less time to dedicate to each client.

Although zones were soon expanded and little concrete damage was done, flexible application of zone management had begun and thereafter was difficult to curtail. From that point on, it was not uncommon to find multiple loan officers operating in the same zones, or

[37] "Viable" implies the fulfillment of basic requirements, such as having owned a business for more than a year and having no significant credit history problems with Corposol or any other institution.

[38] A pervasive characteristic of the founder's style in response to concerns or criticism from staff was to retort in such a way as to stifle further objections. For example, regarding potential market saturation, he might say, "What's wrong with you? Don't you see all the businesses right in front of you?" In the early years, staff acquiesced, but over time, such reactions entirely cut off staff initiative in communicating their concerns. This in turn contributed to the president's loss of touch with the organization, and thus may ultimately have impaired his objectivity regarding Corposol's operations.

see loan officers with geographically dispersed portfolios (not ideally efficient in the sense that it can send mixed messages to clients and confuse repayment patterns).[39]

Beyond geographic definition, other aspects of zone management also became more flexible with increasing pressure for growth. In the first years, the transition of Corposol's clients and territory was handled with care over a multiweek period during new loan officers' field orientations. Experienced loan officers would introduce their successors to clients to ensure continuity of service and facilitate the logistics of finding clients' often informal workplaces. This attention to zone transition declined markedly as performance objectives increased, however. When loan officers quit or were fired, their client folders were often distributed among other loan officers with no introduction at all. This resulted in losing clients, both those the new loan officer was physically unable to locate and those uncomfortable with meeting a new loan officer without an explanation from the one who had given them the loan. Moreover, both situations contributed to delinquency. Members of a special team dedicated to the recovery of problematic loans more than 60 days overdue explain that some of the bad loans yet outstanding pertain to individual credit clients to whom loans were distributed without transition in 1994.[40] In part, this problem can be attributed to the challenges encountered by new loan officers who had no assistance in the assumption of those clients.

In May 1996, a methodology specialist from ACCION International evaluated the status of zone management as part of a general operations diagnostic. He noted a system with "little structure," and the lack of written governing parameters. Subsequent efforts were made to improve zoning, yet the results of a similar diagnostic in the first quarter of 1997 showed great variance among branches in zone concentration, management, and loan officer workload. The same diagnostic also reflected the importance of continuity in zone management: both client retention and loan delinquency varied significantly with frequent turnover of loan officers.

In short, Corposol started with an effective mechanism for market penetration that generated healthy growth. Intensive growth has its limits, however. If management had been more attuned to the signs that adjustments were needed, they might have continued applying this strategy in an orderly fashion. Rather, by ignoring the signals of saturation while imposing performance requirements, management inadvertently induced certain deviations from desired operating standards. The costs of this strategy include not only productivity, but also an early impetus for field staff to improvise in response to conflicting mandates, a modus operandi that played a significant role in the subsequent erosion of Corposol's field operation and portfolio.

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[39] More than one loan officer operating in the same zone can generate confusion among clients if the message or treatment they receive is inconsistent. If one loan officer demonstrates more flexibility in loan recuperation, for example, the clients of a stricter loan officer may question why they are held to a different standard than are their neighbors. Doubts of this sort can affect repayment and spread through markets. The same is true as well for other ambiguities in lending policy, which can occur in an informal environment such as the one in which Corposol operated at that time.

[40] Known as the *Fuerza Especial de Cobro* (FEC, or the special recuperation force). This initiative is discussed further below.

PRODUCTIVITY MANAGEMENT

Performance Objectives

Performance objectives were a principal tool management used to engender productivity throughout Corposol's tenure. Staff who joined Actuar as early as 1989 explain that from the beginning, the founder indoctrinated them with the message that growth was a priority. Most employees would agree that these objectives were instrumental in producing the expansion Corposol enjoyed through 1995.

Although people in many fields agree that setting and monitoring goals is a key step toward achieving them, the parameters used to define those goals, the degree to which they are reasonable and attainable, and the nature of reward or penalty for performance all affect the stability of the system as a means to achieve the aggregate goals of the organization. Corposol's clear and unwavering commitment to achieving its goals was admired by some in its heyday, yet the constructs of its performance objectives system had fundamental flaws whose impact permeated the lending operation and proved to have been one of the significant elements that eroded portfolio quality over time.

Corposol management adjusted performance objective parameters many times in the effort to achieve its goals.

- From 1988 through mid-1994, goals were established for acquiring a certain number of new clients and making a certain number of renewed loans. These are generally healthy variables to encourage. The former builds a base for future growth, which should occur naturally as a function of the methodology,[41] and the latter incorporates a degree of attention to client retention, critical to reach the scale from which to profit from investment in small clients.[42] Unfortunately, this system gave insufficient weight to loan repayment. In fact, loan officers who recalled Corposol's first era of financial incentives (1989-1990) remembered that those who prioritized lending volume, even at the cost of portfolio quality, consistently received higher compensation and more recognition than those who were more conservative in their lending practices. The other primary difficulty that arose from this system was management's insistence on increasingly aggressive goals.

[41] Per the step lending methodology, clients who are responsible about repaying their initial smaller loans are likely to borrow successively larger amounts until they cease to require additional financing or disassociate for some other reason. As such, a goal to bring in clients represents an indirect impetus for medium-term portfolio growth without the potential risk of achieving the same through excessive/imprudent immediate-term increases in loan amounts.

[42] Given that small loans do not generate as much income as do large loans, even though their costs are not necessarily proportionally smaller, in many programs that pursue forms of graduated lending, the initial loans made to new clients represent a net investment for the organization, which is recuperated through subsequent, larger loans made to those clients. As such, client desertion, especially of mature clients, represents a significant cost to the organization.

- During the latter half of 1994 and most of 1995, priority shifted to the number of credits disbursed, with the number of new clients as a secondary consideration. On the surface this does not seem problematic. Yet, this change accompanied Corposol's horizontal diversification and launch of new credit lines. The fact that the new products required a credit history (implying that only existing clients were eligible) led to the issuance of multiple loans to the same client. As such, the structure of the performance objectives created incentive for a lending practice that produced overindebtedness in clients.[43]

- Since 1996, faced with the need to reach a sustainable volume of lending as quickly as possible, management has defined the primary objective in terms of the aggregate loan amount disbursed. Management has also strengthened the system by considering portfolio quality with equal weight. The concern at the time of this writing, however, is that the number of clients has become secondary. The prioritization of portfolio volume unaccompanied by close tabs on a corresponding number of clients runs the risk that loan officers will achieve growth by augmenting loan sizes rather than through client generation. Although a faster short-term strategy, this approach could represent higher medium-term risk if rapid increases in loan amounts are not accompanied by sufficient analysis of client repayment capacity. Moreover, it could induce a shift of attention toward clients whose businesses have the greatest growth potential at the risk of abandoning lower-income clients (and, consequently, the institution's original mission).

One aspect of performance objectives that was frustrating to many staff was that definition of the objectives happened autonomously from above, without consistent grounding in past performance as a measure of feasibility. As a consequence, management established goals that became increasingly unrealistic and were resented by staff whose input was ignored.

- Loan officers who began with the institution recall the performance objectives as "reasonable" and "attainable" through about 1990.[44] The objectives established for 1991 made the desired level of lending contingent on the receipt of resources from a donor.[45] But this funding was delayed until midyear, at which point loan officers had achieved only 7 percent of the year's goal because of the resource constraint. The goal was inflexible, however, which required loan officers to use whatever means they could to meet it. This is an early example of the roots of the pressure and consequent sloppy lending that began in Corposol.

- Employees explain that after the experience of 1991, "It was all over" in terms of reasonable goal definition. Once the president saw what could be achieved under pressure, he redefined the standard. Loan officers remember that by 1992, it was

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[43] Beyond the lending implications of this strategy, one could argue that such goal definition is evidence of the conflict of interest between components of the holding company, as Finansol bore responsibility for the quality of those loans, while Corposol saw additional training income for every credit issued, even if this meant charging more fees to the same clients.

[44] The 21 loan officers (24 by year's end) were required to generate a total of 5,000 clients in the course of the year.

[45] 10,000 clients with a projected continual increase in loan officers.

"impossible" to achieve the performance objectives and still pursue all the steps of the standard lending process.

- The president of Corposol rejected the efforts of middle management to provide him with information that would produce more realistic projections. The director of urban lending at that time recalls submitting an annual budget in January 1995 with operational projections based on 1994 performance. He was "almost fired" because the growth he anticipated did not meet the president's expectations. The performance objective for the year autonomously established by the president was nearly double what this director considered feasible.[46] This had the doubly negative effect of disempowering and demotivating one of Corposol's key operational managers while ignoring an important indicator of the status of field operations, which could have helped avoid problems. Over time, this style of interaction eventually cut off essential communication flow from the field upward, as employees came to fear rebuke or gave up on making a difference.

Another ultimately negative characteristic of Corposol's performance evaluation system was the enforcement mechanism applied. Failure to comply was not uniformly used as a signal for constructive criticism, troubleshooting, or diagnosis of the need for institutional support. Nor was achievement consistently rewarded. Rather, management policy was primarily penal. Negative reinforcement could range from relatively minor forms, such as reprimand or public recrimination by management, to severe measures, such as dismissal. [47] Enough loan officers were made examples of that the threat was very real.[48] Unfortunately, such punitive measures appear to have produced more negative consequences than positive effects on productivity, as demonstrated by evaluations of employee morale and motivation performed by third parties at different points in time.

Undoubtedly, without its aggressive application of performance objectives, Corposol would not have enjoyed the explosive growth it generated through 1995. However, the lack of an effective balance of priorities to ensure attention to portfolio quality, unrealistic goals, and the severe penalties imposed for noncompliance generated a decline in lending standards and practices that many cite as critical roots of the crisis.

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[46] Although detailed data that would permit the tracking of performance objectives over time is unavailable, some employees remember seeing their original monthly goals double or triple by 1995. This increase is even more significant considering the growing number of loan officers working to meet those goals in increasingly saturated or dispersed zones.

[47] Such reprimand could include exclusion from management and communication courses offered for professional development and team building. This was counterintuitive, however, as ultimately mechanisms that restricted staff development were counterproductive for the organization itself.

[48] Although exact data with the required level of specificity are unavailable (for reasons discussed above), employees recall that by 1994 this technique had become more prevalent, resulting in an average of about one dismissal per month for noncompliance with performance objectives, and that by 1995 this had increased to about two per month, independent of the larger scale housecleaning that occurred in 1996 and 1997.

Productivity Tools

Beyond application of performance objectives and the zone management techniques discussed previously, Corposol used other tools to enhance efficiency in field operations. In the early years of the organization, these manual tools included the following:

- A time-management structure for organizing clients geographically to minimize unnecessary travel between zones (known as the *rutero*).
- A format for monthly planning of activities per the dates of loans due that require evaluations, "investment control" of newly disbursed loans, or routine follow-up visits. This format was designed to help loan officers organize their time per their priorities.
- A grid for "monthly control of portfolio and activities," which reflected much of the same information from the other sheets, expressing commitments for the month in a graphic format (known as "bingo").[49]

Most staff and supervisors describe these tools as useful and, initially, care was taken to ensure their correct usage. Standard application fell by the wayside for many loan officers, however, when faced with pressure to produce at all cost. Ironically, in the period of peak volume, some new employees were not even taught how to use these tools "in the interest of time."

As the information systems began to produce more complete output, reports such as the monthly loan recuperation projections, weekly portfolio summary, and daily overdraft summary reduced the need for manual forms of operational accounting. In some branches, however, loan officers continued to rely on earlier manual mechanisms because of the unreliable timing in receiving systems reports. As of October 1997, no unified norm existed for the application (or lack thereof) of these instruments.

As was the case with other good practices employed in Corposol's early operations, it appeared that decline in the application of productivity tools accompanied the other degenerative processes, such as the blurring of zones and the variability of the credit process and methodology. Although decline in the usage of such tools did not drive Corposol's demise, together with other mechanisms, such as zoning, ineffective use of some of the tools could have limited Corposol's advancement.[50]

[49] There was no uniform opinion about this worksheet; some saw it as a duplication of effort and, therefore, a waste of time.

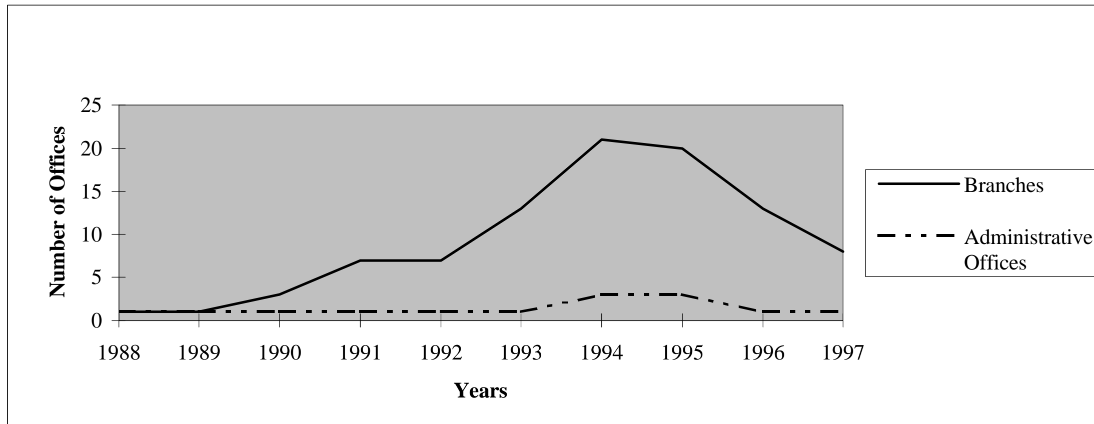
[50] Note that Finansol management at the time of this study had taken steps to address some of these issues. For example, in the latter half of 1997, branch markets were rezoned with the collaboration of ACCION International field staff.

GEOGRAPHIC EXPANSION

The Scale of Corposol's Growth and Decline

Corposol's initial geographic expansion was gradual. As noted earlier, operations during 1988 and 1989 were carried out from the central office. As reflected in Figure 5, the first branch offices were opened in 1990, and gradual expansion occurred through 1991. At that point, the program was operating from seven offices, a level maintained in 1992. Expansion more than tripled over the next three years, however, to reach a high of 24 offices by early 1995. Not only did this pace generate numerous challenges for the organization, but worse, many of these offices were subsequently closed, beginning in 1996, as Finansol attempted to recuperate from the crisis, representing a huge cost to the organization. As of January 1998, Finansol had eight offices, just one more than Corposol had in 1991.

Figure 5: Opening and Closing of Offices



Market Selection and Development

Decisions to open offices were made in many ways. The first three offices opened were determined by the founder and his first three employees, who were responsible for coordinating the work of loan officers at that time. These first targets were in some of the poorest zones with the most concentrated populace of microentrepreneurs. One of the offices was selected in part because of the availability of funding from a donor targeted to that area, a practice that also played a role in some subsequent expansion.

Later, zone selection was somewhat more decentralized, often building on the growth from existing offices. From 1992 to 1994, any branch manager could suggest a branch opening and provide the criteria to be evaluated for approval. Most frequently this occurred in zones around existing offices that had grown beyond their capacity. The first expansion into more rural areas was in fact generated by sprawling urban operations. New branches were opened first in the immediate surrounds of Bogotá (known as the *cabeceras municipales*); these eventually became the predecessors to the first Agrosol operations.

Efforts were made to establish good policies for expansion in the first years, but many were not applied in full or for very long.

- Management spoke of the principle that the optimal number of loan officers for an office was seven, a number it thought would optimize the leverage of the office investment without creating a load unbearable for supervision and control. Under this theory, when an office grew to the point of needing more than seven loan officers to manage its existing clients, a new office should be opened to split the load and provide a base for further expansion. In practice, however, this principle was not applied consistently. One former branch manager remembers a point in 1992 when she was supervising 21 loan officers until a new office could be opened. Such cases of excessive personnel load set the stage for the deficiencies in oversight, as discussed in Chapter Five.

- In theory, a zone diagnostic was to be completed prior to market entrance. Most staff interviewed recall, however, that not much credence was given to the requisite diagnostic form. They completed it, but often without much true analysis, as in many cases "the decisions were already made."

- To optimize experience in opening new zones, another idea practiced from 1991 to 1993 was branch manager rotation. The principle here was twofold: (1) to provide cross-fertilization between Corposol's different markets; and (2) to create an indirect mechanism for ensuring the objectivity and independence of branch managers by avoiding the possibility of their becoming overly entrenched in personal staff or client relationships at any particular branch. Although employees interviewed consider this to have been a positive experience, rotation later became occasional rather than routine, in order to safeguard some operational stability in the context of the wildfire expansion.

The Failure of Corposol's First Branch

In 1990, possibly as one of the first initiatives in Corposol's future pursuit of "integral development," Actuar Bogotá gave a loan to the founder's sister and her husband to establish a health center for clients. Clients could elect to pay a monthly quota to use center services. When few clients chose to use the service, the founder suggested that if loans could be disbursed at the center, this might encourage clients to check out the health services at the same time. Faced with the fact that they couldn't very well ask the nurse to conduct the disbursement session for clients, loan officers were sent to the health center, from which they decided they also might as well conduct their lending activities. Thus, the Quiroga came to be Corposol's first branch. Unfortunately, the health center failed, the loan entered arrears, and branch lending operations had to be moved to a new office. The first branch manager of Quiroga later agreed that had this first expansion been a purely business decision, it is unlikely that the office would have been located where it was. This represents, perhaps, the first example of the following four-part cycle that was later to prove fatal to Corposol: (1) the launch of a new endeavor based on an interesting concept but with insufficient analysis of demand or feasibility; (2) the attempt to support or even induce the success of a shaky initiative by bundling it together with a stronger component of operations; (3) some costly mistakes; and (4) conflict of interest. Although the loan for the health center was mentioned to the board, it was cited as an example of an innovative development, and the borrower (without specific mention of who) was portrayed as a "microentrepreneur." Corposol had no specific policy prohibiting insider lending at that time.

Despite the relative informality of the above process, staff concur that the first wave of new offices during 1993 and early 1994 in general "made sense" and were still relatively healthy

and stable. By early 1995, however, expansion had begun to take a more aggressive turn, as revealed in the following anecdotes:

- Field staff began to notice signs of saturation in some zones, suggesting that the quest for further intensive growth within existing markets would no longer be as effective as the dedication of those resources to broader geographic expansion. Nevertheless, in 1995, the executive director mandated the opening of branches in zones already serviced by other branches.[51] This was justified under the premise of market penetration, but the strategy discussed internally by management with central-office staff made it clear that a primary reason for this questionable decision was the president's belief that internal competition among staff for clients and market share would further drive their productivity. This later proved to be a detrimental strategy, in that it augmented pressure and consequent imprudent lending while inducing a trend toward individualistic behavior by loan officers at the cost of team or institutional commitment.

- In April 1995, another new strategy was applied. Operating on the premise that increasing the volume of staff is the fastest means of inducing growth in clients and lending, the president decided to promote several new branch managers who would open the next group of new branches.[52] A competition to develop market entry plans was held, and nine winners were selected to open branches. Although in theory the managers' analysis should have provided a solid base for expansion, in many cases they were assigned to markets that had not been evaluated and that later proved problematic. Moreover, these decisions were made without regard for the institution's capacity to manage such a rapid increase in its number of branches.

Agrosol expansion followed a similar curve. As at Corposol, early operations occurred in concentrated zones and were controlled by few staff. However, large increments in staffing determined by the central office in search of new clients induced outreach to communities far beyond earlier bounds.[53, 54] Often this was done from some central point; loan officers lived together in certain communities and would travel to conduct their business in the field rather than opening offices. As such, the shape of expansion was more difficult to control and, consequently, less orderly. As of early 1996, a field diagnostic conducted by the president of Finansol showed Agrosol clients in 70 rural municipalities. Though such outreach is desirable from a social standpoint, the resulting geographic dispersion in conjunction with volume made it impossible for loan officers to meet their goals while doing adequate follow-up or providing technical assistance worth what clients were required to pay. The impact on lending practices and portfolio quality was severe.

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[51] The 1995 branch openings also entailed the relocation of some branches within existing markets. Although the desire for more intensive growth within the markets is understandable, this process of infrastructure readjustment represented a financial and operational cost to the organization.

[52] Note that the crisis was already brewing at this point; a fact that illustrates the nature of the president's decision making at that time.

[53] The program originated in October 1992. During 1993, loan officers began operations in what were referred to as the north and east zones. In 1994, activities expanded to the south.

[54] Staff size more than tripled from the end of 1993 through the end of 1994. To meet goals, staff began to lend in two additional zones.

Additionally, ad hoc extension of operations without sufficient market analysis led to lending in areas that later proved to be problematic. Examples include rural zones with significant preexisting problems, such as guerrilla activity; climatic conditions that affect crop yield; or previous delinquency with other institutions. At least one region outside of Bogotá was opened to receive grant funding. Though a market analysis was presented to justify the decision, the community proved to have insufficient demand and market conditions very different from those in which Corposol's methodology functioned well. Lending operations never reached sustainable levels, and the office was later closed.

In conclusion, some of Corposol's geographic expansion was pursued in a healthy and sustainable manner. But increasingly aggressive strategies generated stresses on the lending operation that exceeded the capacity of existing personnel, infrastructure, and systems. The resulting portfolio quality implications, as well as the physical cost of opening new branch offices that were subsequently dismantled, testify to the flaws in the way this strategy was executed.

PRODUCT DIVERSIFICATION

Corposol's approach to new product development was consistent with the way it approached development of the institution itself. Buoyed by the visionary enthusiasm of Corposol's leader and the "can-do" mentality inspired by the organization's success to date, Corposol management took ideas from conception to implementation at an astonishing pace.[55] From late 1992 through late 1994, management initiated the Agrosol program, purchased a commercial finance company to establish Finansol, created the Corposol holding company, and launched new lines of credit for Mercasol and Construsol.[56] By any definition, such a trajectory represented a dramatic change to the shape and operations of the organization in very little time.

The Concept of Growth through Product Diversification

The concept of product diversification as a means of growth presents a paradox in the case of Corposol. Rather than addressing different types of demand or complementary market niches, most of Corposol's new credit lines were in fact designed to meet new needs of the

[55] Corposol had already initiated some forms of product diversification. In addition to the staple solidarity lending (which functioned with a methodology through the experience of institutions in many countries) and the individual loan program begun in 1990, from 1990 to 1992 Corposol offered fixed asset loans, which clients could use to complement their group or individual working capital loans. Such loans were a natural progression from working capital loans and were given subject to parameters to limit risk to the group. As such, the concept of parallel lending was not entirely new to the organization and had been successful.

[56] Some staff also recall a brief experiment with consumer loans for household appliances, but this was never formalized. At the same time, fixed asset loans were re-introduced in 1994 along with the other new products, increasing the number of possible simultaneous loans a client could hold to four.

same target clients.[57] This fact is the basis for two structural flaws in the growth Corposol achieved through financial product diversification: cannibalism of growth from existing products and an aggregate increase in the amount loaned to each client rather than an increase in client base.

Effect on Lending Composition

During the period in which these new products were launched, Corposol's aggregate active portfolio grew from C$9,600 million (US$12 million) at the end of 1993 to about C$38,000 million (about US$38 million) at the end of 1995, an increase of more than 300 percent in dollar terms. However, note that much of this growth replaced the institution's proven solidarity lending. The progression of charts in Figure 6 shows that whereas solidarity group loans represented 86 percent of the amount Corposol lent during 1993, during 1995 they represented only 30 percent of the total amount lent. This represents a relative decline in importance and an absolute reduction, as well as a net substitution in lending from Corposol's most traditional product toward products with less tried methodologies.

The same changes occurred in terms of number of loans. The charts in Figure 7 show that in 1993, 90 percent of Corposol's loans were to solidarity groups, while as of June 1995, these loans represented only 60 percent of Corposol's portfolio.[58] Although the total number of loans increased by 60 percent during that period, the number of solidarity group loans grew by less than 6 percent.

Some of this shift was actually induced by management policies. For example, in an attempt to increase client use of Mercasol services, management at one point allowed clients with relevant types of businesses to receive their disbursements only via Mercasol products. Not only did this contribute to the shift from Corposol's standard forms of lending, but it backfired; clients who did not find value in Mercasol's services, and who did not appreciate the institutional restriction over what they were allowed to do with their loans, left the institution.[59] In such cases, beyond cannibalism, product diversification reduced potential net growth.

Although the original concepts that provided the basis for Corposol's product diversification were good, the concept of economies of scale does not necessarily imply that economies of

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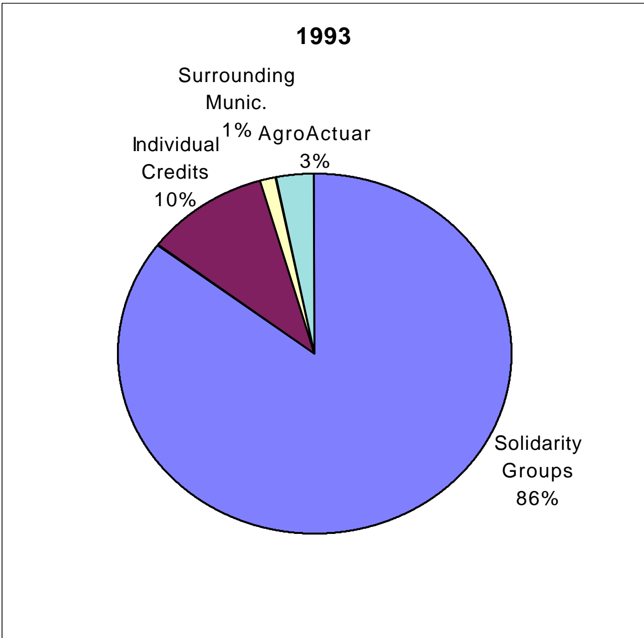
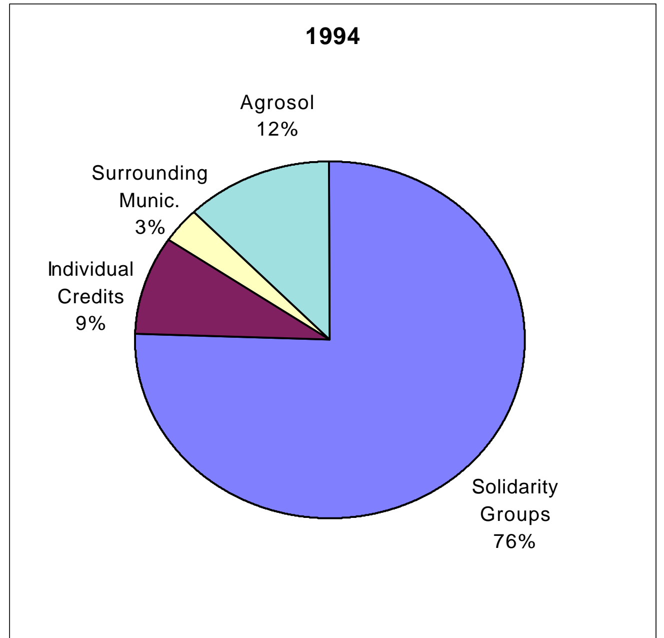
[57] This was not a coincidence, but rather, by design. Working from the premise that knowledge of a client's credit history was essential, and hoping that access to new credit lines would serve as an incentive for responsible repayment, Corposol management made clients eligible for fixed asset credit only as of their second loan, and for Mercasol or Construsol credit, only as of their third loan. This precluded the possibility of diversifying the client base through these new products.

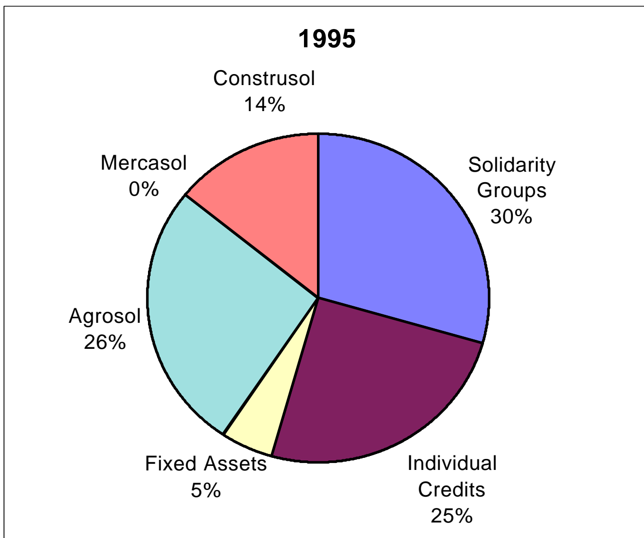
[58] In interpreting these figures, note that Mercasol, Construsol, and fixed-asset loans were given only to clients who already had solidarity group, individual, or Agrosol loans. After 1993, when parallel products were introduced, these numbers represent the composition of the total number of loans, not number of clients, because some clients had more than one loan.

[59] This experience may also shed light on the pros and cons of directed credit, which has long been an issue among microlending practitioners.

Figure 6: Distribution of Amount Loaned, by Product







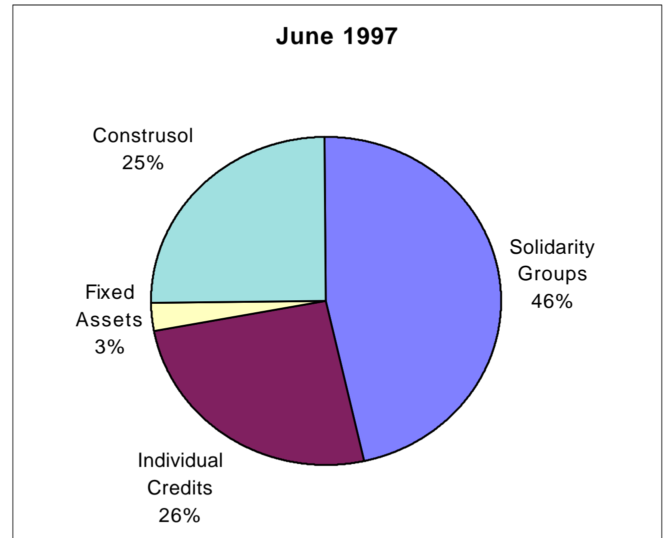
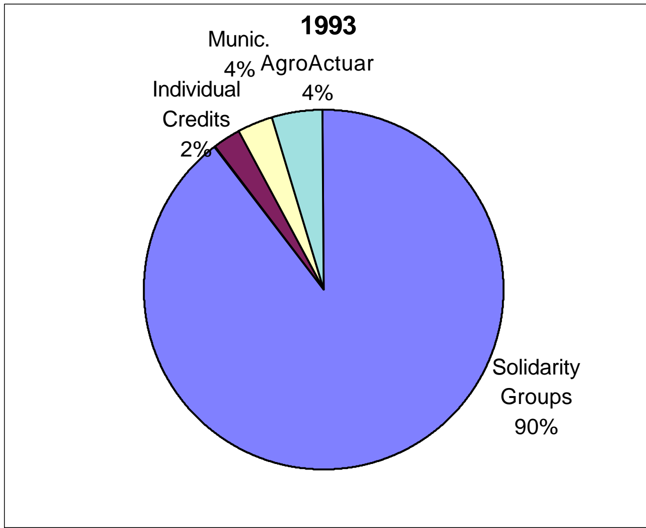
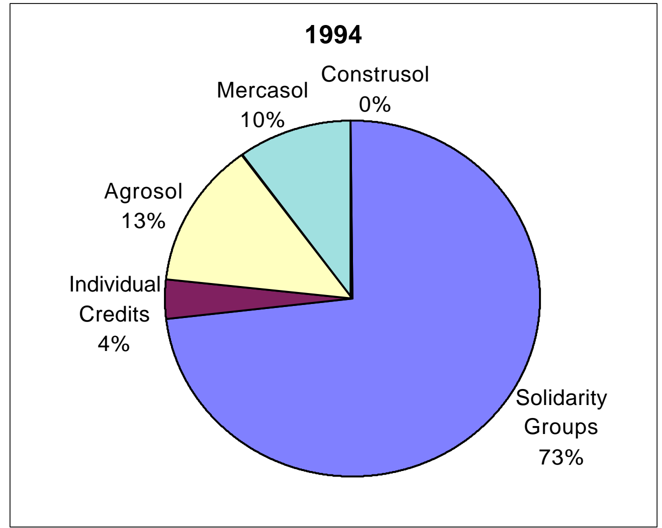
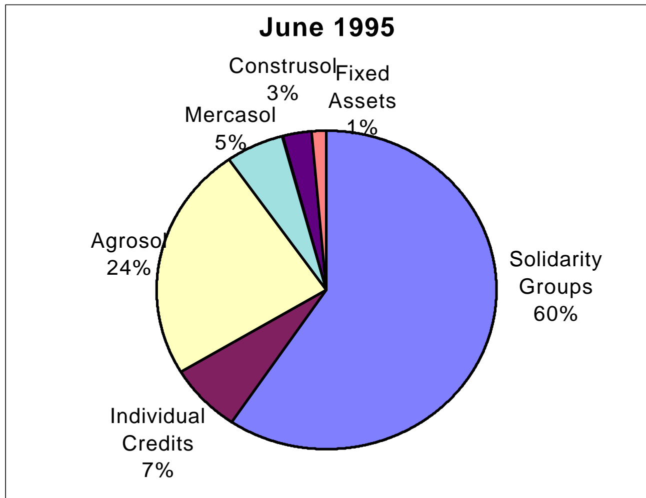
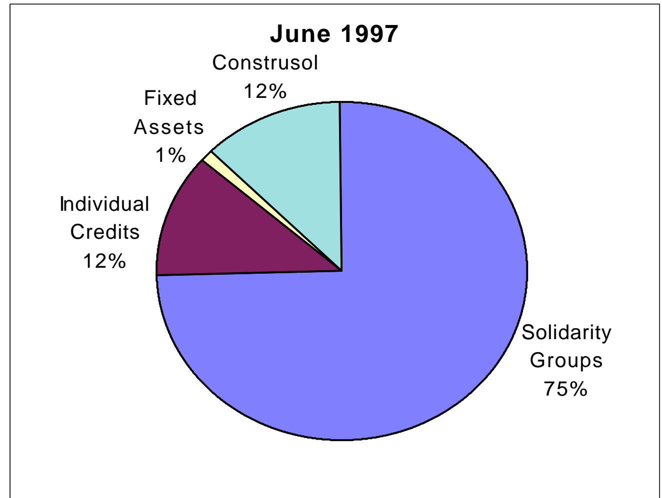


Figure 7: Distribution of Number of Loans Made, by Product









scope exist.[60] Recognizing that a substantive improvement in clients' quality of life might require the improvement of multiple areas of their lives is a compelling idea, and the goal of developing ways to address those multiple needs is admirable. However, the downfall in Corposol's attempts to implement such theory came in misunderstanding how clients define their own needs and in failing to determine the best way to respond to those needs while serving clients' best interests.

[60] Note that the 1997 figures above demonstrate a return to earlier lending composition. This trend reflects the decision to return to lending via proven methodologies, one of several strategies implemented in Finansol in its recovery.

CHAPTER FOUR: ORGANIZATIONAL DEVELOPMENT RELATIVE TO GROWTH

Although some of Corposol's growth-generation strategies may have been problematic, the scope of their negative impact would have been less had the holding company's organizational development progressed at the same rate as did its operations. This chapter discusses the evolution of Corposol's staff development, organizational design, and institutional culture and the adequacy of each relative to the challenges posed by Corposol's trajectory.

STAFF DEVELOPMENT

The personnel of any service organization are an integral component of the engine that drives both volume and quality of production. As such, the systems that affect the performance and motivation of personnel throughout their tenure with the organization play a central role in the efficacy of operations. This is particularly true in microfinance organizations that depend on both the client-loan officer relationship as a central tenet of their lending methodology and on the efficiency of back-office support to achieve critical operational agility.

The following section analyzes the evolution of various aspects of personnel management in Corposol. At the branch level, the discussion addresses determining the need for additional field staff; selection and hiring processes; training; incentive systems; and performance evaluation. At the administrative level, topics include approaches to hiring and developing middle management, back-office, and support staff. Many of these functions were affected by Corposol's rapid growth, resulting in personnel weaknesses that contributed to the subsequent deterioration of operations.

Field Staff

In finance institutions, branch-level staff are ambassadors of the institution in client service; their ability to make good loans and their responsibility in recovering them drives portfolio quality, and their productivity affects profitability. As such, the processes employed in developing front-line personnel and engendering their performance are a primary focus in this analysis.

Formation of Loan Officer Staff

The number of clients managed by a given loan officer will affect the amount of time that loan officer has available to dedicate to the credit evaluation, loan issuance, and follow-up that each client requires. Consequently, beyond some maximum client load there is a risk that reduced attention will lead to less thorough credit decisions or loan monitoring and the possibility of deterioration in loan quality. At the same time, however, the more clients each loan officer can manage, the more potential portfolio growth can be achieved at the same cost, representing a corresponding increase in profitability as a function of productivity.[61] The reverse is also true: loan officers who manage fewer than a certain break-even number of clients (below which their collective portfolio does not generate enough income to justify the cost of the loan officer) represent a net cost to the organization.

These tradeoffs make the management of an optimal client load per loan officer critical to both a healthy portfolio and branch profitability, as either insufficient or excessive levels of physical productivity can have negative consequences for the institution. In the early years of Actuar Bogotá, this relationship was carefully managed by staff at the operational level. Lending began with a benchmark of 60 groups (or approximately 240 clients) per loan officer, a target suggested by the aggregate experience of the affiliate institutions of the ACCION International network. Procedure dictated that each loan officer would work to build up his or her portfolio to the point where the aggregate number of clients per loan officer in a given branch exceeded that benchmark, thus indicating the need to augment the number of staff in that branch. When a new staff member arrived, he or she would receive a portion of the portfolio from a loan officer with an excessive client load. In this manner, the process of reducing the burden to a manageable level for one loan officer constituted a head start for the other. At the same time, this mechanism was intended to help balance the mix of new and old clients managed by each loan officer, in hopes of distributing their effect on loan officer productivity.

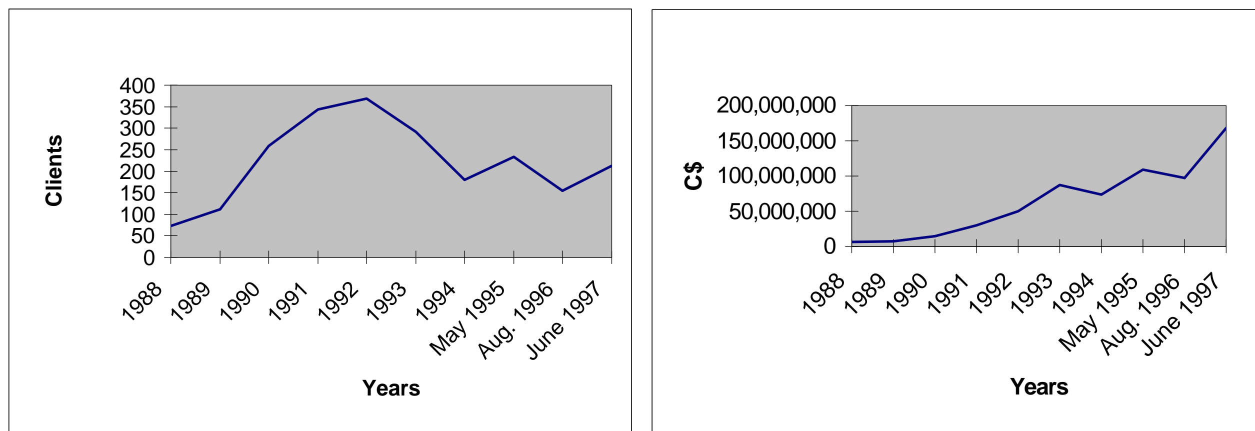
During 1988 and 1989, the aggregate average number of clients per loan officer was still below the original benchmark.[62] In December 1990, however, the average exceeded the

[61] Another dimension of this relationship is financial productivity, or the portfolio volume managed by each loan officer. If a loan officer's clients borrow successively larger amounts (a natural tendency in step lending), then over time that loan officer's portfolio (the basis for income generation) will increase for the same number of clients. Client maturation and other variables can also affect a loan officer's physical productivity positively or negatively. Loans made with longer terms are renewed less frequently, implying fewer instances of loan processing in a given time period than shorter-term loans would require. As such, a loan officer with many mature clients could conceivably manage more clients because of the slower aggregate rotation of loans. At the same time, however, the degree to which a loan officer spends more time evaluating or following up on loans of a certain type (larger loans, new loans, and so on) also affects this relationship. Unfortunately, statistical information that would have permitted a more detailed analysis of factors such as time utilization in Corposol lending is unavailable. As a result, this study focuses primarily on the resultant variables of physical and financial productivity, rather than on the contribution of each of their potential drivers.

[62] This low aggregate average does not preclude the possibility that some loan officers at times managed excessive workloads while others were underproductive, particularly during periods in which many new loan officers were hired. Again, information that would have permitted assessment of relative levels of productivity among Corposol's loan officers is unavailable.

benchmark at 258 (see Figure 8). By the end of 1991, the organization's founder had raised the benchmark number of groups per loan officer from 60 to 80, or approximately 320 clients, in hopes of further leveraging the existing staff via augmented productivity. In both 1991 and 1992, actual averages exceeded this benchmark, at 344 and 368 clients per loan officer, respectively, suggesting that the volume of loan officers did not fully keep pace with parameters defined to support client growth. Although Corposol's portfolio quality had not yet begun to decline, interviewed staff associate this period with the excessive workloads that precluded their compliance with lending procedures such as monthly follow-up visits. As an initial example of lowered lending practice standards, this could be considered an early seed of the crisis.[63]

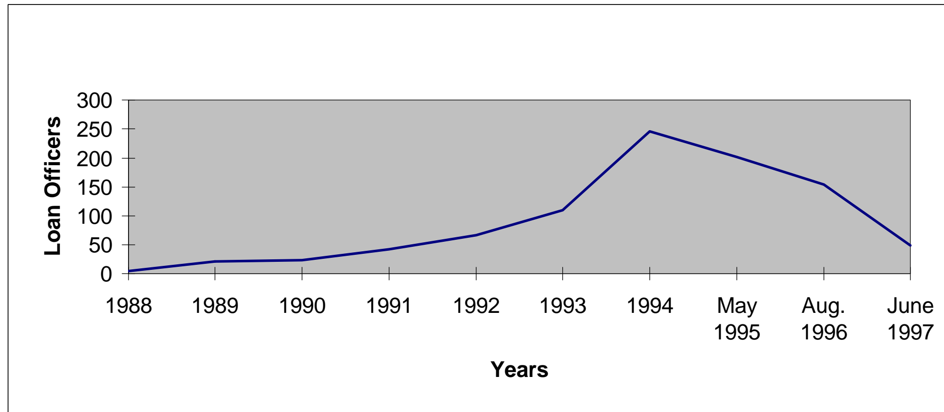
Figure 8: Average Number of Clients per Loan Officer and Average Amount of Portfolio per Loan Officer



A more significant change in front-line staff size administration occurred in late 1994 (see Figure 9). Branch managers in both the urban and rural programs were surprised when they began to receive significantly more new loan officers than they had requested per client volume: central-office management had begun a new strategy of hiring in hopes of accelerating growth. This change in strategy posed some operational challenges. Ironically, the augmented volume of new staff both lowered overall productivity and caused excessive overburdening of existing staff. This resulted from the fact that management required branch managers to achieve aggregate compliance with performance objectives. The volumes of new staff raised the overall objectives for each branch, requiring experienced loan officers to take on even heavier burdens until newer employees could come up the learning curve and build their portfolios. Some interviewed staff recall managing as many as 120 to 130 groups during that period (which would never be reflected by aggregate averages), which compromised their ability to follow comprehensive lending procedures.

[63] Note that this benchmark itself is not unreasonable relative to the numbers of clients managed by loan officers in many similar programs. One might in fact question whether requirements such as monthly follow-up visits were merited and feasible given the nature and volume of Corposol's clients. Nonetheless, this is an example of conflicting institutional mandates that led to loan officers' circumvention of established lending practices. Regardless of whether the practice or the response made sense, this pattern became prevalent over time, with increasingly serious consequences.

Figure 9: Number of Loan Officers Over Time



Problems were compounded by the fact that some markets were already too saturated to absorb the efforts of additional loan officers, often leading to deviations from planned zone management. Both lending and zone aberrations went largely unchecked, as the influx of new staff strained existing training and oversight capabilities. At the same time, sustaining an augmented number of staff at low levels of average productivity until they could begin to generate portfolio represented a cost to the institution. Finally, this practice frustrated branch managers, who saw their staffing recommendations overridden by central-office decisions with negative consequences.

Clearly, of the two strategies applied at different times by Corposol management, the practice of gradual demand-driven hiring of loan officers applied from 1988 to mid-1994 was more effective in supporting stable levels of growth, with incremental cost commensurate with that growth. The second strategy of attempting to increase volume via hiring resulted primarily in a reduction of productivity and a dilution of staff consistency. Although such management of front-line staff size alone would not have induced Corposol's crisis, the resultant strains on the field organization's integrity and consequent operational costs did exacerbate Corposol's growing operational and financial difficulties.

Selection of Loan Officers

The Selection Process. Corposol's founder hired his first three loan officers from a pool of candidates who responded to a newspaper ad. However, when the need arose to hire another group, he suggested that those three, with their understanding of what the job entailed, would be best able to recommend appropriate candidates. Thereafter, during 1988 and 1989, new loan officers were brought in entirely from recommendations made by existing staff. This gave experienced staff close, personal control over hiring standards during that period. In 1990, however, the organization once again began to advertise publicly for candidates, as hiring needs exceeded the number of candidates that could be generated by existing staff. In 1992, a psychologist was hired to help with the process.

Nonetheless, until early 1994, the original three loan officers continued to play a key role in loan officer evaluation and selection, although final decisions were centrally controlled.

As early as 1990, this personal screening process was amplified to become a "two-way selection" process in recognition of the fact that it was critical for candidates to gain early on a clear understanding of Corposol and the nature of a loan officer's responsibilities. This was to ensure that those selected would join the organization with appropriate expectations. As such, all loan officer candidates were given a "pre-orientation" introduction to Corposol's mission, target sector, lending methodology, and so on.

Another advantage incorporated in this selection methodology was the opportunity for branch managers and other loan officers to participate in candidate evaluation. The process incorporated two days of field visits, after which branch personnel presented their assessments of each candidate, allowing their input and at least partial ownership in the final decisions. An estimated 10 percent to 20 percent of participants who had otherwise made it through the screening process at this point were rejected or decided not to continue. Human Resources staff attributed to this mechanism a reduction in staff turnover, representing cost savings for the organization. From September 1994 on, this pre-orientation strategy was extended to candidates for all functions, in recognition of the importance of managing staff expectations and commitment at all levels.

In 1994, together with the formal creation of a Human Resources Department designed to serve the whole Corposol holding company, a function dedicated to recruitment, selection, and hiring was established. The process was amplified and formalized still further, with the goal of improving the quality and retention of staff. The new selection process could last from 8 to 15 days and included requisition (by department); advertisement through universities and the press; résumé screening by Human Resources staff; pre-orientation for selected candidates; psychological tests and an interview; and an interview and final decision by the supervisor of the position to be filled.[64] Thereafter followed an orientation course and a two-month trial period.

Although this selection process overall yielded adequate personnel, instances of exceptions to defined procedures may have weakened certain aspects of the process. For example, in addition to the official recruiting channels mentioned above, there were candidates recommended by executive management. These candidates may have been very qualified, but cases of nepotism and other bias at visible levels of the organization fueled speculation and rumors among staff. The scale of this practice is difficult to quantify, and at the loan officer level appears to have been minimal. Nonetheless, even a few questionable cases can influence employees' perception of the justice and transparency of hiring.

Profile. Corposol sought to hire loan officers with professional degrees in related fields, such as economics, business administration, or industrial engineering for the urban program and veterinary medicine or agronomy for the rural program. As discussed above as a motive behind the two-way selection process, one challenge in seeking such a profile lay in the

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[64] In the case of loan officers entering after 1994, this process would also include the *curso concurso*, discussed below.

alignment of professional expectations with the realities of the position.[65,66] Moreover, some of the most critical abilities for loan officers were more a function of "street experience" with certain social sectors than anything else. For these reasons, the academic and professional profiles of prospective loan officers formed only part of the selection criteria.

Some of the first loan officers, who later as coordinators were responsible for hiring new loan officers, explain that one of the most important characteristics sought in new staff was a system of sound values and ethics that coincided with the institution's mission. When asked how such an intangible element was analyzed, staff explained that this was best handled personally by one of the experienced loan officers, who, on the basis of their understanding of the mission, could assess the integrity and commitment of each candidate during field visits to client zones. According to the same staff, it was precisely this element that became harder to manage when Corposol's volume of hiring began to grow. In the absence of written parameters to govern criteria, and facing candidate numbers that precluded the same degree of personal assessment by experienced loan officers, the earlier consistency of standards eroded.

The profile of loan officers hired also changed over time. As the market began to perceive Corposol's instability, fewer candidates were interested in seeking employment there, thus reducing significantly both the size and quality of the pool of applicants by late 1995.[67] Even had this not been the case, however, the other structural elements that shaped employee behavior on the job had a far greater effect than either the selection process or the employee profiles in terms of the human resource weaknesses that contributed to the crisis.

Incorporation and Training of New Loan Officers

Initial Training. In the early years (1988-1989) of Actuar Bogotá (later Corposol), the orientation process for new loan officers was brief and fairly informal but sufficient to achieve uniform preparation, as operations from a single central office allowed for consistent transmission of concepts and support during the learning process.

During this period, the founder of the organization conducted a three-day introduction to Actuar, using the primary tenets of the reasons and methodology for working with microentrepreneurs that he had learned with Actuar Tolima. Loan officers then learned about lending itself on the job, working in the field with clients, and were accompanied by the founder until they could uniformly apply his procedures and standards.

By early 1990, the original loan officers had taken over the orientation process, which they managed through 1993, when Finansol was established. As their executive director (Actuar's founder) had once done, they managed the three- to four-day introductory course on Actuar's

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[65] This was generally defined as having completed college course work, which does not necessarily include having completed the final thesis required for a university degree.
[66] For the same reason, candidates were generally culled from a specific mid-caliber group of universities rather than from premier institutions.
[67] As measured by both the institutions from which they applied and the skill sets of candidates.

mission, culture, lending methodology, and administration, as well as the subsequent process of accompanying new staff during on-the-job learning. After their initial introduction to fieldwork, new employees received some number of clients from an existing loan officer and had a month to develop their portfolio before being held to compliance with performance objectives.

The initial training experience of loan officers at Agrosol (the only other program at that time) was similar to that of urban program loan officers. New Agrosol staff participated in the same orientation program and then were introduced to fieldwork during a two- to four-week "welcome" by the experienced loan officers in their communities. Much like urban loan officers, Agrosol staff who started in the early years emphasized the importance of the mentoring they received from their more experienced peers in the gradual transition of client groups (referred to as "*colectivos*") and in their collaboration in providing technical assistance to clients.

When employees who entered during this period were asked about the degree to which they felt sufficiently prepared by this process, they explained that a majority of their learning necessarily occurred on the job, on the credit committee or in the field, as they encountered and responded to new challenges with clients. This method made the ongoing support they received from experienced loan officers all the more important and any variation in its quality critical. Other loan officers emphasized the fact that because the initial training was minimal and informal, the quality of the learning process and subsequent performance depended a lot on the initiative, effort, and commitment of each new employee. Some staff cite these elements as reasons that inconsistency in training and lending quality began to develop.

In recognition of this fact, the orientation training was expanded to a full week, with more specific attention to details of the credit process formerly transmitted principally on the job, including the lending methodology and techniques for economic evaluation, complete with exercises for filling out the required worksheets and loan documentation. This did not diminish the importance of follow-up to ensure effective application of these concepts in the field, however.

Effect of Dramatic Growth on Mentoring

Staff who provided the initial training in these early stages considered the process to have been effective by and large through approximately 1991. However, as a function of subsequent dramatic growth beginning in 1992, the volume of new staff began to exceed that of experienced staff, reducing both the possibility of centralized control of initial training as well as the ability to support subsequent learning in the field.[68]

[68] Among other aspects of lending, the one-month training and accompaniment phase was squeezed by time constraints relative to performance pressure.

Middle management recalls moments in 1994 and 1995 in which this situation was so severe that the training of new loan officers was entrusted to employees who had been with the organization for as little as a few weeks. Worse, in the absence of formal lending guidelines and oversight, new staff learned the fruit of their peers' improvisation, which in many cases included bad habits, such as shortcuts, that facilitated compliance with performance objectives at the cost of sound lending practices.

In 1994 and 1995, the Human Resources Department, in response to both the degree of variance in application of Corposol's methodology and ensuing delinquency, developed the following initiatives:

- An expanded initial training course designed to broaden and standardize the skill set transmitted to new loan officers, in order to reduce reliance upon nonuniform on-the-job training. At the same time, this interactive introduction to the institution became part of the selection process in hopes of ensuring that new loan officers would all begin with certain abilities. Known as the *curso concurso*, or contest course, this process was structured to permit Human Resources staff to select candidates on the basis of their performance in the course.[69]

- A feedback process to occur two weeks after each orientation course, in hopes that follow-up reinforcement and troubleshooting would ensure a consistent application of learning.

- A one-week "reorientation" course to refresh experienced loan officers' knowledge of

Effect of Dramatic Growth on Mentoring

The impact of a large-scale influx of new loan officers on a system that relied on mentoring by experienced staff was clear in the reflections of one Agrosol fieldworker interviewed by the author. He recalled how the incorporation of new loan officers changed over time in his region. During early expansion, there may have been 10 experienced loan officers to train 20 new ones. New staff were carefully accompanied by experienced loan officers until they were ready to assume *colectivos.* By early 1996, however, he recalls that 8 of those 10 experienced staff members were sent to new regions, and those remaining were hard pressed to receive and train the next group of 30 new loan officers. By this time, new staff often received a stack of *colectivo* folders with very little else from peers who had only been with the organization for a few months.

The ensuing lack of consistent training produced operational gaps even with respect to very basic procedures. The same fieldworker recalled a new loan officer who was unaware that he should submit the receipts after collecting money from clients. This resulted in clients who had paid being reported as delinquent in Agrosol's manual system. At the same time, other experienced staff report that newer loan officers who were asked what Agrosol did and why had completely varied answers, indicating a lack of understanding of and identity with the mission of the organization. These experiences demonstrate the dilution of consistency in field operations as a function of rapid personnel expansion in the absence of sufficiently standardized training and procedures. The impact of this dilution was particularly pronounced in Agrosol because of its highly decentralized operations. However, similar experiences were not uncommon in the urban program as well.

[69] Although one might question whether such extensive training of loan officer candidates who had not yet been contracted represented undue cost to the organization, training staff the study team interviewed make a good argument for the cost/benefit of this strategy. The candidates who participated in the *curso concurso* had already been through all other aspects of the selection process, and thus represented a selected group of finalists, all of whom had qualified for the job via that process. The course allowed staff to evaluate another dimension of these candidates; namely, their concrete aptitude in the skills required for the position. Compared with the alternative of discovering a loan officer's weaknesses in the field after portfolio transference, and incurring the additional expense of their replacement, the *curso concurso* proved preferable.

conscientious lending practices, with the hope of achieving a more uniform level of application of the methodology.

Although employees interviewed considered these initiatives important in the quest for more standardized lending, the initiatives never had the impact they might have, as it seems they were introduced too late.

- The *curso concurso* was implemented on a monthly basis from its launch in October 1994 through September 1995, when the last loan officers were hired for Corposol/Finansol. Although branch managers who received loan officers who were the product of the *curso concurso* agreed that they were better prepared than previous groups of new employees, the officers' commitment to applying what they had learned in the course did not last long. Rather, as they accompanied their peers in the field, they were exposed to the fact that few experienced loan officers were as diligent as they had been taught to be. The new officers soon learned that the good habits they had learned were inconsistent with compliance with performance objectives, and they began to follow the lead of their more experienced peers. Essentially, despite efforts to improve the initial training of new loan officers, ad hoc operational practices in the absence of standardized oversight had become so entrenched that the bad habits of existing staff were perpetuated among new staff.

- Trainers' attempts to initiate a feedback process to reinforce training concepts were frustrated by the tendency mentioned in the previous point. New loan officers complained that what they had been taught was not practiced in the branches and thus were unresponsive. Such follow-up was subsequently discontinued, as its initiators became discouraged.

- The reorientation course was never fully implemented. Its debut generated a clash with the existing lending habits of experienced loan officers that was even more severe than the one new loan officers encountered after the *curso concurso*. At the same time, management did not lower performance objectives for participants during the course, which created both resistance and stress among participants. Thereafter, management discontinued the course, on the grounds that there was no time for it. This lack of support for an initiative designed to achieve uniform lending standards represents a clear example of management's prioritization of production over aspects of organizational development that could have safeguarded portfolio quality, including consistent personnel training.

Inconsistency across Branches

One staff member who started as a loan officer in March 1992 recalls being sent to two different branches for his orientation to fieldwork and was greatly surprised at the operational differences he encountered between branches. In the absence of a standardized written policy, the branches practiced differing degrees of abbreviation of the traditional lending methodology, eliminating steps such as the initial group meeting to discuss concepts of solidarity. Staff explain that this practice can be attributed partly to the fact that pressure to meet performance objectives induced a tendency on the part of staff to seek ways to "streamline" the lending process in order to augment their productivity. The results of this tendency were compounded by the lack of systematic oversight or other standardized quality-control mechanisms. Collectively the results weakened on-the-job training as a means of achieving consistent skill sets among employees.

Ongoing Training. Corposol did not have a comprehensive plan for ongoing personnel training to meet staff's learning needs or to further professional development. The organization did pursue one type of periodic training from 1989 to1995 in the form of a series of workshops on "Management and Communication" offered by ACCION International. The workshops focused on teamwork and leadership, among other interpersonal and professional skills. Although they were very well received by staff, the workshops responded to only some of Corposol's evolving personnel needs and were considered more of a reward for performance (or as leverage to induce performance or punishment for lack thereof) than a form of ongoing professional development.

Corposol personnel training staff explain that beyond the Management and Communication program, courses were offered occasionally in response to specific institutional challenges. Unfortunately, such efforts were reactive rather than visionary and often failed to provide lasting solutions. One example cited was the attempt to address portfolio quality concerns in 1995. Efforts included a workshop given by specialized lawyers on loan recuperation in an attempt to prevent cases from reaching the point of judicial intervention. But only two people per branch were invited to participate (in order to avoid distracting operational staff from their productive activities), demonstrating the low level of priority that management accorded such courses. Moreover, the course was held only once, in October 1995, despite the fact that portfolio quality problems were ongoing.

Management detected other training concerns as well, such as the lack of financial analysis skills and the importance of reinforcing certain methodological concepts in the interest of achieving a higher degree of consistency in lending. However, the organization provided only sporadic and insufficient training in these areas. Some employees remember occasional technical training in specific topics (for example, cash-flow analysis), yet in general complain that the focus of such courses was not applicable to the circumstances and characteristics of their informal-sector clients. Regardless of the degree to which such courses could have contributed relevant insights or skills, the fact remains that Corposol's lending practices did not reflect the benefit of such courses. It is important to note, however, that beyond course contents, the lack of internalization and/or application of learning was also a function of the lack of sufficient follow-up and reinforcement mechanisms, oversight to guarantee application, and the negative influence of other structural aspects that failed to reinforce but rather impeded application, such as the conflict between compliance with performance objectives and lending quality.

Although the aforementioned initiatives contributed in varying degrees to employee development, as Corposol grew in scale and complexity, a gap opened in staff preparation. Management failed to recognize the importance of accompanying new operational initiatives with the appropriate personnel training. For example, in 1994, when the group of loan officers that had managed all individual lending was disbanded, client files were distributed among existing solidarity group loan officers. However, the individual credits were made with different forms of guarantees, and often featured larger amounts or longer terms than loans made to solidarity groups. Any of these variables could represent different forms of credit risk if not analyzed appropriately, yet the solidarity group loan officers were given no additional training prior to assuming responsibility for these unfamiliar clients. These loans

subsequently proved problematic, as reflected in Chapter Five. The Corposol holding company's introduction of other products posed a similar set of new challenges for loan officers and was also unaccompanied by sufficient staff training.

Adequacy of Training. Indications at various points in time suggest deficiencies in the degree to which Corposol's personnel training prepared staff to generate and recover healthy loans.

- A staff member who served as "portfolio manager" in 1991 (a role that, at that time, gave him primary responsibility for recuperation of problem loans), explains that even then, a principal cause of delinquency (even more so than deviations from the methodology) was insufficient credit analysis on the part of loan officers, which led to the overindebtedness of clients. This is a particularly interesting observation given the fact that in 1991, lending was still relatively simple: loan officers worked only with the original primary products, and still found performance objectives manageable. Thus, if deficiencies in credit analysis were already perceived at that time, one can only imagine how the diversification of products and an increase in lending volume (without the necessary additional credit analysis training for staff) subsequently affected credit quality.

- The aforementioned initiatives of the Human Resources Department beginning in 1994 offer another indication of the training deficiencies that staff perceived.

- During the last quarter of 1995, the new president of Finansol conducted an institutional diagnostic, which cited poor initial and ongoing technical training as one of the weaknesses of the organization. In his view, the fact that Corposol was hiring loan officers with inferior profiles and that such loan officers were given little formal financial analysis training was one key element responsible for the decline in portfolio quality that had come to a head by mid-1995.[70]

- A field analysis conducted in January 1997, which included assessment of loan analysis and documentation, as well as credit committee observation, showed that loan officers were unclear about how and why to do a cash-flow analysis, a concept central to the determination of client repayment capacity. Such loan officers completed and submitted the requisite forms but still based their lending decisions primarily on clients' assets or guarantees rather than repayment capacity. This reflects in part a conservatism or fear of lending, which can be attributed to the experience of wrestling with the consequences of poor lending that resulted in delinquency during the crisis. More important, however, this departure from the methodology resulted from the fact that when loan officers wanted to begin prioritizing the quality of their lending, they lacked the training and tools to do it and thus resorted to the crutch of guarantees to protect themselves. The same diagnostic cited branches in which loan officers established credit conditions (loan amounts and terms) with clients even prior to having collected any financial or operational information about their businesses, suggesting that the officers saw little

[70] His evaluation cited as an example that even most of the winners of the *curso concurso* were unfamiliar with the most basic accounting equation: assets = liabilities + equity, one relationship essential to assessing a client's debt capacity.

relationship between loan amounts and clients' working capital needs or repayment capacities.

Overall, staff from various operational areas, including Human Resources, cite deficiencies in personnel training as an important contributor to the poor lending quality that reached a high point in Corposol in 1995. However, most agree that better training alone could not have preempted the crisis, as demonstrated by the manner in which good initiatives were insufficiently supported by management and ill received by employees. Rather, the efficacy of staff training must be viewed in the context of the other structural and cultural variables that affected operations and employee motivation.

Client Trainers

Given the fact that Corposol charged its clients a fee for training tied to loan disbursement, in theory, as the number of credit clients and loan officers grew, so too should have the institutional ability to provide good training. Although this variable does not have the same immediate implications for performance indicators as does management of the number of loan officers relative to growth, it does affect the nature of services clients receive for their money. As this affects the cost/benefit to clients, at some point, given alternative sources of credit, it is likely to influence client satisfaction with the program. In other words, the quality and cost of client training could contribute to desertion and delinquency, both of which have a significant cost to the program and as such must be addressed in a comprehensive assessment of growth management.

The selection of client trainers during Corposol's initial period was pushed through, with positions offered internally to loan officers without any particular requirement of experience in training. Although many of the loan officers who volunteered were very committed to their new responsibilities and made fine trainers, some with whom the study team spoke cited reasons other than the desire to be trainers for changing their positions. With field personnel already experiencing stress during this period, some interviewees said they volunteered because they thought trainers would have better hours, experience fewer demands, and would not have to comply with performance objectives. Such motivations may not have been the ideal self-selection parameters for effective trainers.

Trainers expressed that they received little support from the institution in developing the pedagogical skills required to be effective. In some cases, they were given materials with which to teach; however, loan officers who became branch-level trainers did not recall any formal training in the techniques of adult education, which is likely to have had an impact on their efficacy as trainers, at least at the outset.[71]

In a subsequent phase, trainers were hired externally rather than from the pool of loan officers; however, they came from the same group of candidates from which new loan officers were selected. Hence, they were no more likely to have experience in training than

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[71] During different periods, Corposol utilized training materials from the Carvajal Foundation and Centro ACCION. Other materials were internally developed, with varying results.

were loan officers; furthermore, they were even less likely to have experience working with the microentrepreneurial sector. Staff maintain that this change in strategy was a result of the desire to preserve the operational productivity of loan officers, not to improve training services.

When the shift to hiring external trainers occurred, these new staff members were given the same general orientation to the organization and sector as the loan officers received (an orientation that, at least as of 1994, was fairly comprehensive). Nonetheless, like their predecessors, these new trainers were given no specific pedagogical training. Some who were loan officers at the time argue that many of the new trainers would have benefited from additional support in understanding the needs and characteristics of Corposol's clients, and in learning how to relate to them.

In 1994, an additional layer of technical trainers was added, after completion of the *Ciudad Bolivar Centro de Servicios Básicos* (a community "Center for Basic Services" located in Ciudad Bolivar), which, among other things, featured workshops for teaching concrete trade skills in areas such as garment construction, baked goods preparation, handicrafts, and computer literacy. These trainers were hired on a contractual basis and were already specialists in their fields. Although this last phase represents an advance toward augmenting client training capacity, by some measures it remained insufficient relative to the scale of client growth.

Branch Managers

Initially, promotion of branch managers occurred in a logical manner: As additional loan officers were hired and branches opened, the more experienced loan officers assumed additional responsibilities. Although these new managers were not given any specific training to prepare them for their new roles, they were still closely accompanied by the founder of the organization, whose guidance and supervision provided an ongoing tutorial in all aspects of operations.

As the organization began to grow more rapidly, many new managers were promoted, generally from those who had been the most successful loan officers. Like the previous generation, these new managers were not given any specific training to fulfill their new responsibilities; however, they did not benefit from ongoing mentoring to the same degree that had been possible when the organization was smaller. Results over time showed that having been a good loan officer would not necessarily ensure that one would be an effective manager; in many cases, such individuals lacked specific skills or abilities critical to their new positions.[72] These deficiencies, coupled with the lack of training support from the organization, generated staff turnover among branch managers and led to a variable level of operational quality among branches. At the end of 1991, for example, six new branch managers were promoted in anticipation of the opening of new offices in early 1992. Four of

[72] Such skills might include personnel management, financial and planning skills, and branch administration, among many others critical for a manager though not developed during one's tenure as a loan officer.

these did not make it through 1993 and 1994, and the other two left in 1995. This failure rate made it clear to middle management that something was wrong: "We were losing our best loan officers by making them ineffective managers," commented one.

In 1995, the new Human Resources Department pushed for a more comprehensive internal selection process that employed a set of criteria better attuned to the skill set required of a good manager. In May of that year, the first *curso concurso* for branch managers was implemented. Similar to the process described above for loan officers, the idea was to create a competition for the promotion to branch manager that would require participants to demonstrate the relevant skills (or potential) they would bring to the position. In this case, candidates were asked to develop a plan for opening a new branch complete with market analysis, feasibility assessment, and operational, financial, and human resources plans. The overarching principal governing the *curso concurso* was the idea that branch managers should be selected on the basis of what they could bring to the tasks required, tasks that could differ significantly from those they had performed as loan officers.

Staff response reflected the number of loan officers who were eager to demonstrate their potential. The Human Resources Department received 79 résumés in response to the first internal advertisement of the *curso concurso*; for 32 of these, the submitter was invited to participate in the course, representing a far broader pool than would likely have been considered under the previous mode of selection. Both this participatory aspect and the fact that the selection criteria were transparent were cited as highly motivational by many current and former staff interviewed. At the same time, supervisors of branch managers agreed that the *curso concurso* as a means of selecting branch managers represented a significant improvement.

Yet although this process was both favorably received by staff and was considered to have improved the nature of selection, the loan officers chosen nonetheless would have benefited from training in skills specific to their new positions.[73] In recognition of this fact, a detailed curriculum to train new branch managers was designed.[74] At various points during the development process, however, management reduced the time approved for the course work and at the last minute canceled it altogether, on the grounds that the managers could not afford the time away from their productive labors. Although a subsequent attempt was made to convey the same concepts in a sort of correspondence course, workloads inhibited participant response. As such, the training was never fully implemented.

In conclusion, the efficacy of branch-level middle management was critical to the effective decentralization of all the other processes previously discussed. Consequently, management's failure to prioritize adequately branch managers' development compromised the quality of the whole field operation.

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[73] Note that although participants in the *curso concurso* were judged on their leadership potential, ability to work in and manage teams, and knowledge of the business and the methodology, they were not evaluated for specific technical skills that most did not yet possess. Rather, the intent was that the managers selected would subsequently be trained in those skills.

[74] This initiative was pursued by the Human Resources Department in collaboration with organizational development professionals from ACCION International.

Performance

Incentive Systems

In a highly decentralized field operation, the cost and logistics of monitoring loan officers' work increase the importance of cultivating employees' internal drive and commitment to performance. This requires an important role for incentive systems. Corposol's experience reflects how the structure of such systems affects the degree to which they succeed in eliciting the desired performance.

Performance-driven Financial Incentives. Corposol used financial incentives to encourage the productivity of its branch-level employees at three different points in time, yet none so far has produced the desired combination of results.

The first monetary incentive plan was implemented in 1989, during the second year of operations. Staff who worked under the plan recall that it had several positive elements:

- There was a clear set of parameters that governed bonus pay, making it a transparent process easily followed by loan officers;
- Compensation was awarded monthly to individuals based on their work, a system that clearly linked potential financial rewards to performance, thus serving as an immediately reinforcing incentive;
- Employees recall that it was possible to earn as much as 20 percent to 30 percent above their base salaries in bonus pay, which was significant enough to be a real incentive. Moreover, even if objectives were not met, employees experienced no reduction in pay below their base salaries.

This plan was discontinued in 1990 for the following reasons:

- The principal emphasis of the parameters established under the plan was on the generation of new clients; employees recall that having low levels of delinquency weighed only an estimated 30 percent in their total evaluation. As a result, employees who prioritized volume over (or even at the cost of) quality in their lending stood to benefit more financially than loan officers who pursued more conservative lending practices. Not surprisingly, staff who were loan officers at this time recall that delinquency had already begun to rise during this period.[75]
- Employees became accustomed to earning at the levels permitted by their bonus pay, and thus were hard pressed to adjust to downside fluctuations. This became increasingly

[75] Unfortunately, personnel who contributed to and worked with the statistics also explain that figures had already begun to be "adjusted" in order to present a good image, making it more difficult to demonstrate this tendency.

> problematic as the expanding performance objectives became ever harder to meet. Employees concur that they would have preferred to have had a moderate increase in their base pay than the volatility of potential highs and lows in their bonuses.

In 1995, financial incentives were reintroduced. Unlike the first incentive system, this one was not introduced with defined, stable parameters that could serve as targets for employees. Rather, staff describe the incentives during this period as uncertain and volatile, a condition that contributed to the operational "chaos" that resulted from the frenzied pressure to lend.

In early 1997, a third version of financial incentives was implemented as part of the Finansol management's campaign to remobilize field staff and increase commercial production. Although good in concept, the plan's primary problem, according to staff, is that it by and large has been unattainable. The head of the Credit Department explains that since the origination of the program, as of the third quarter of 1997 only about 7 employees had met all the plan's goals. That figure averages out to less than 1 employee per month out of 50 employees. This low number is attributable not only to the fact that the performance objectives established seek to promote Finansol's ambitious growth projections, but also to the fact the plan was structured to require compliance with each distinct objective, leaving little flexibility. Such a plan can cease to be an effective motivator if it is perceived as unattainable.

Generalized Employee Benefits and Rewards. Other types of rewards were applied at various times during Corposol's history. One type were benefits extended to all employees. For example, at the beginning of 1994, management implemented a generalized salary increase for employees (excluding top management) of 50 percent, along with improved insurance benefits and vacation time. A survey on "organizational climate" in early 1994, however, showed that these measures had been insufficient to motivate employees.[76] This may in part reflect the depth of damage already done by negative aspects of the operational environment. At the same time, however, the fact that all employees received the same treatment regardless of performance, and that the benefits were awarded in an "autonomous" fashion after the fact rather than as a function of a pre-established framework, reduces the degree to which employees would see their reward as driven by performance, and thus reduces the direct incentive produced.

Other generalized benefits or rewards were offered in an ad hoc manner over time. One such measure was paying for weekend outings or similar activities for the best team of branch personnel. On the positive side, such measures supported the development of team spirit and cohesion. However, they failed to differentiate between good and bad performance within a branch, and failed to recognize the good performance of many employees in branches with low performance. Finally, as above, the fact that these rewards were established in the absence of transparent, pre-established parameters made the link between performance and rewards tenuous and therefore the incentives less effective.

As mentioned above, participation in training courses was also sometimes treated as a reward (or more often as a penalty for noncompliance). Yet this had the unfortunate effect of depriving

[76] Performed by the Fundación Neohumanista, Santa Fe de Bogotá.

precisely the employees who might need more assistance of such support; thus, this was not a strategy that benefited employees or the organization. Corposol did not take the subsequent step of offering participation in more extensive professional development training as an incentive.

Performance Evaluation

Corposol's historic experience with formal performance evaluations was sporadic and less than ideal in its results. Evaluations were not planned on a consistent basis with well-defined parameters against which employees could measure themselves. Nor were they used as a positive vehicle for feedback and improvement. Rather, they tended to have punitive results, leading employees to consider them a threat.

Prior to 1992, performance evaluation occurred only on an ad hoc basis according to the criteria of each branch manager. Primarily the criteria were a function of quantitative variables, such as compliance with performance objectives, without any significant weight given to other measures, such as client service quality or teamwork.[77]

The first formal, institutionwide performance evaluation was conducted in late 1992 at the impetus of the deputy director of Corposol. On the surface, this evaluation appeared to be a good one. Staff explain that the instrument itself reflected a gamut of good criteria, and the process of evaluation was intended to be an interactive one with employees. Unfortunately, the experience was less than optimal, for the following reasons:

- When branch managers returned with the completed evaluations, they learned that, independently, the same manager who had initiated the evaluation had already performed his evaluation of staff primarily on the basis of employees' numeric compliance with performance objectives. Subsequently, 28 people were fired per his decisions rather than as a result of the evaluations, which led branch managers to believe that their efforts had been solicited merely for justification purposes. Such behavior on the part of central management contributed to middle managers' gradual disillusionment with their leaders and the consequent decline in their trust and motivation to collaborate.

- Worse, the evaluation process at the branch level was not in all cases as collaborative as it might have been because of the time pressure for production. Nor was it perceived as transparent, as the criteria used in the evaluations did not coincide with those applied in the firing decisions. These facts, in conjunction with the associated firing of a significant number of field personnel, produced a generalized mistrust of performance evaluations on the part of staff.

As a result of the negative staff response, management conducted no further formal evaluations for some time apart from the ongoing enforcement of performance objectives. The next use of evaluations occurred in early 1996, shortly after the resignation of Finansol's second president, with a similar focus as that applied earlier: the rating and "housecleaning"

[77] A primary measure of performance during this period was success under the first financial incentive system, discussed above.

of loan officers. This and subsequent rounds of evaluation and firing, pursued by Finansol's third president, perpetuated the negative image generated by the first evaluations.

In early 1997, the human resources representative in Finansol attempted to put in place a new, more positively focused model for performance evaluation. After the first round, however, the initiative was curtailed by the president, who held a lesser view of the quality of branch-level personnel than results indicated.

In sum, attempts at performance evaluation have served primarily as a utilitarian tool for management and a source of insecurity, rather than feedback, for staff. Although the lack of an effective performance evaluation mechanism cannot be considered a direct cause of Corposol's crisis, it can be considered a lost opportunity. If integrated with the oversight process, a performance evaluation system might have been used to detect generalized problems and apply corrective measures before poor lending practices had gone too far.

ADMINISTRATION DEVELOPMENT

Although the development of an effective field staff is paramount to establishing a strong microlending operation, the functioning of the governing and supporting administrative layer can determine the efficacy of the operation as a whole. Especially when an organization has achieved a high degree of functional decentralization, as Corposol had, quality operations require fluid informational exchanges, back-office support, and effective supervision.

Many new and growing microfinance organizations struggle to determine the right balance between the technical and professional skills required and the understanding of microentrepreneurs and appropriate service methodologies necessary for effective middle management and administration. Put more simply, the essential tradeoff can be defined as the following: staff originally hired as loan officers and promoted from within the organization may not have had the specific technical training required to assume new administrative responsibilities; yet they do have an understanding of the idiosyncrasies of the microentrepreneurial sector and lending operations, critical to many decisions, which externally hired professionals would lack. The reverse is also true. The degree to which one skill set should ideally take precedence over the other and the weight of the tradeoff is necessarily a function of the nature of each position.

In addition to the sources of middle management and the potential skills tradeoff dilemma discussed above, the manner in which middle managers are selected has an inevitable effect on the employees they supervise. The transparency of the criteria applied and the selection process itself may greatly influence how other staff receive and respond to middle managers. At lower levels, employee perception of equity of opportunity and career paths within the institution can affect motivation and commitment. The following section discusses the degree to which staff were promoted internally or hired externally at Corposol, the manner in which they were selected, the support internally promoted staff were given to develop any new skills required, and the functional impact of each strategy.

Hiring Mechanisms and Their Impact

Upper and Middle Management

Corposol Executive Management. Initially, the only "management" of Actuar Bogotá was the founder himself, who was still integrally involved in operations. As discussed above, the initial expansion of hierarchy occurred only at the operational level, with the most experienced loan officers moving into the role of supervising new field staff but without any increase in administrative management.

When Corposol began to grow to the point of diversifying beyond its original urban lending operation, it needed to find leaders for the organization's new functional units. One could argue that new endeavors such as Agrosol's rural lending and Mercasol's merchandising were areas in which professionals with technical expertise were required to supplement and lead the efforts of experienced Corposol personnel. However, this is not what happened per se. Managers were hired from outside of the organization, but early in the operations of both Agrosol and Mercasol it became apparent to staff that the professionals hired to lead the new initiatives lacked sufficient experience in those areas to avoid some of the pitfalls each encountered. The same occurred at lower levels, with lower-profile implications but at a cost to the organization nonetheless.

The hiring of inadequate upper and middle management had multiple implications and negative consequences:

- From a purely operational perspective, the new initiatives could have been analyzed, developed, launched, and supervised more effectively by professionals with more expertise in these functional areas.

- Experienced staff who started the field operations of the organization expressed a sense of betrayal that top management positions were given to externally hired professionals who, in the estimation of internal staff, were less suited for the positions than were those familiar with Corposol's field operation. Over time, staff who reported to managers whose performance and judgment they felt did not merit their respect became increasingly unmotivated, working out of obligation rather than beliefs or commitment. Such a sentiment could greatly hinder productivity or, as in the case of Corposol, when performance objectives mandated productivity, reduce employees' commitment to the quality of their service and lending.

Employee dissatisfaction was compounded by the fact that neither the process nor the criteria for selecting these managers were transparent to employees who had previously been the "right hand" of the founder, leaving them to question the imposition of a layer of executives above them. Moreover, many of those appointed also had some previous personal or

professional connection to the founder.[78] Although personal references are not an uncommon source of hiring, this contributed to the perception on the part of staff that those top managers were hired for their loyalty to the president rather than for their ability. This, too, had negative operational implications:

- Regardless of the degree to which employee doubts or perceptions were valid, they damaged both the credibility of the new managers and the perceived integrity of the president. These wounds to staff members' faith in their leaders bled slowly at first but over time, with subsequent incidents, infected the general morale and value system of Corposol's work force.

- Personal ties may have contributed to the absolute power the president wielded, as those professionals who held positions they likely would not have qualified for in the marketplace knew that their friendships as well as their jobs were at stake if they were to go against the president's wishes.

All these elements suggest that autonomous appointment of managers from above, without a defined recruitment process or selection criteria to safeguard the objectivity and transparency of standards, runs the risk of destabilizing an organization's personnel structure.

Finansol Executive Management. The importance of management formation took on new dimensions in Finansol. Finansol was to be the first for-profit entity of the Corposol holding company, one responsible to shareholders. At the same time, as a CFC, Finansol was subject to the scrutiny of regulatory standards, and its credibility among institutions of the financial sector would affect its market access and the cost of funds. With these considerations in mind, Finansol hired a management team of 12 highly qualified individuals with experience in the Colombian banking sector.

Two professionals with extensive Corposol field experience also joined the team, to manage credit and portfolio operations in Finansol. Although it was hoped that this combination would permit Finansol to achieve a symbiosis between the perspectives each group brought to the team, sheer numbers precluded such a balance. Rather, this Finansol management team established itself with the operating standards and approach it considered appropriate for the management of a formal financial institution. Unsurprisingly, this approach in part conflicted with the Corposol staff's modus operandi. One might have predicted the differences that arose over the issue of standards for loan approval, as the credit analysis parameters applicable in traditional banks would disqualify a good number of Corposol's clients. Moreover, such differences in lending standards proved part of a broader clash between Corposol's accustomed informality and the trappings of a more formal operational culture associated with Finansol's first management team.

Such differences might have been reconciled had other aspects of operations been harmonious. Unfortunately, however, even some of the areas expected to benefit most from

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[78] In fact, staff jokingly referred to such managers as members of the "Ibagué club," as many of them hailed from the same region of Colombia as the president. Later, this tendency was compounded by cases of nepotism.

the new team's previous banking experience encountered challenges. For example, one of the primary reasons for creating a CFC was to ensure the holding company had sufficient liquidity via capital market intermediation. Yet, despite the extensive experience and relationships enjoyed by those professionals, they discovered that making inroads in the financial markets was not as clear-cut as had been hoped because of the financial sector's lack of experience with institutions like Finansol, among other factors. This resulted in a liquidity crisis in December 1993, which led the institution to fall back on Corposol's lending capacity via its accustomed funding sources.

Corposol management decided to change its strategy, given that the former bankers' lack of familiarity with the nature of microfinance was complicating lending operations and that even the new skills they were intended to bring to the table were falling short of expectations. As a result, in April 1994, after only five months, all but a few key specialists were replaced with former middle managers from Corposol.

It might seem easy to conclude (as Corposol management did at that time) that this experience weighs heavily on the side of internal promotion rather than external hiring. Yet, the true reasons for the cultural and operational clash suffered during those first five months and, more important, the degree to which the external hiring and subsequent replacement of the first Finansol management team made sense can be analyzed from many angles.

- Some have argued that the primary problem was that Finansol's first management team failed to share Corposol's vision for Finansol and failed to understand its social mission. Yet, one might ask whether more could have been done to help the team gain the desired insight and reconcile the clash.

- Others question whether mission and vision should affect how the management of a regulated financial institution views its fiduciary responsibilities. The fact that the clash between Finansol and Corposol continued long after the first Finansol management team was replaced suggests that the core difference may have been between Corposol's informality and Finansol's need to be accountable for its operations, as discussed below.

- With regard to the question of the value of externally versus internally acquired professional skills, subsequent experience lends additional insight. Finansol's second president, who came from Corposol, had experience in business but not with running a financial institution. After his resignation in 1995, subsequent presidents came from major institutions of the financial sector, all of whom made indispensable contributions in managing the crisis, recapitalizing the organization, and rebuilding Finansol on the basis of their experience. This affirms both the value of that experience and the fact that it need not be incompatible with that of internally developed staff.

- Given what we know now, some have questioned whether the true clash between the first Finansol management team and Corposol in fact had a different genesis than that previously supposed. The new team was the first group of external professionals to come in at a level of authority that had no predetermined allegiance to existing Corposol management. This has led some to question whether the clash was at least in part

because the team's desire to exercise independent authority conflicted with Corposol management's absolute control.

In short, the various phases in the development of Finansol's management reflect the challenges that can result from failure to reconcile differences between externally hired and internally promoted managers. Yet, in the case of a regulated microfinance institution, each of these has the potential for both significant value added and shortcomings, affirming the importance of working toward an effective complementarity.

Internally Promoted Corposol Management

Although the hierarchical levels within Corposol were somewhat difficult to define, none of the highest managers came from within the organization, and upper middle managers were chosen internally in only very specific cases. The latter in part was so because Corposol's administrative functions, oriented primarily around the functioning of the holding company, had fewer natural transitions from the original business than did those of Finansol, whose lending activities required administration in areas most related to field operations and could consequently benefit from the experience of former field staff. For example, when Corposol management decided to create its Human Resources Department, it labored to define an optimal profile for the manager of the new department. Most often, such positions are held by professionals in the disciplines of psychology, personnel, social work, industrial engineering, or other areas related to the organization, development, and management of human resources. However, management decided that this department should also play an important role in monitoring the pulse of the organization through its personnel while serving as a bridge between field operations and management. This required the perspective of an insider who had knowledge of the organization's history, an understanding of its mission and operations, personal credibility, and the trust of staff. Consequently, management decided to assign the position to a field operations manager who had been with Actuar from its inception and had held both branch-level and supervisory positions.

The field operations manager initially objected to the assignment because she lacked formal training and experience in human resources management. Then, recognizing the validity of the arguments for hiring from within, she accepted the challenge with her superiors' assurance that she would be supported with the necessary professional development. After a minimal course, however, the "lip service" for support ended. Despite having to start from scratch, this professional strove to do the best job possible, building a department with a staff dedicated to hiring, personnel training, and benefits and launching many of the positive initiatives described in this report.

Ultimately, many of the arguments for staffing this position internally proved to be valid and yielded positive outcomes:

- An external hire could not have perceived employee needs or responded to them in the way this person did, as years of experience with the institution afforded her the criteria

necessary to make good, independent decisions, which was not always the case with externally hired managers.

- More important, despite the fact that management created this position just as autonomously as it had those of the top managers described above, the results were completely different. Despite her lack of preparation for the position, the new human resources manager was well received and supported by her former peers. In part this can be attributed to the fact that she already had their respect. The absence of an explicit process was offset by the fact that her track record with the organization offered clear criteria for her selection.[79]

This is not to say that this strategy for internal promotion was not without its downfalls:

- This professional might have accomplished more easily many of the efforts she undertook had she received more comprehensive institutional backing for her professional development or for hiring skilled support staff (which may have been less critical in the case of a professional trained specifically in the field of human resources).

- Because the manager lacked experience in human resources management, certain critical functions (such as payroll management) were handled by other senior managers, thus disaggregating what should have been integral elements of personnel management.

- By that stage in the organization's history, internal employees who stood up to the president were handled in a way designed to disempower or marginalize them, in this case evidenced by the fact that more than one initiative fizzled because of a lack of management support.[80] As such, an external, objective professional, fresh to that power dynamic, might have been able to safeguard more authority.

In conclusion, as evidenced by the above example and others, the internal promotion of middle managers in Corposol had pros and cons. Although those professionals promoted internally had potential unique avenues for making contributions, their ultimate performance in new positions was in more than one case inhibited by a lack of institutional support for new skills development and by a power structure that obstructed the authority that would have permitted them to develop fully in their new responsibilities.[81]

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[79] Another key difference was the fact that most staff had perceived the need for a human resources function, and thus saw the position as a response to that need rather than as an arbitrary position created by management.

[80] It bears noting that despite many significant contributions, this professional left Corposol frustrated on sabbatical in late 1995. The burnout of good employees was just one destructive outcome of Corposol's power structure.

[81] Some would argue that this was the case for Finansol's first president, for reasons discussed above.

Back-Office and Staff Positions

Corposol's minimal back-office staff was not significantly expanded until about 1991, when Corposol had 42 field employees estimated to have been managing a volume of more than 14,000 clients at the end of that year.

When there was a need for support staff to grow, the tendency was to hire new (external) people for the positions rather than take trained staff away from field operations they were still working to build. At the same time, positions in areas such as information systems, accounting, and treasury management inherently required a certain set of technical or professional skills that could only be gained through formal training or experience. In such cases, staff did not question the necessity to hire specialists.

As central-office functions began to diversify and include more positions related to the administration or support of field operations, external hiring was no longer the only clear choice. Frustrated field staff complained that they were not given the opportunity to explore alternative career paths within the organization, as they were not advised when positions came open. The same staff began to lobby for the opportunity to compete for central-office positions, particularly those their field experience could benefit.

In light of this desire voiced by employees, together with the potential efficiency gains of hiring from a pool with a known track record and the benefit of diversifying potential career paths available to employees, when three positions related to credits and budgeting opened in late 1993 with the purchase of Finansol, management decided to look within the organization. Employees were evaluated on the basis of their experience with the organization (with a requirement of at least six months' tenure), their previous studies and/or relevant professional experience, and a test of general knowledge and skills relevant to the position.

Unfortunately, this first experience was not what it might have been. In the absence of a Human Resources Department (which had not yet been created), management hired an independent psychologist to evaluate the candidates. Ironically, that person's lack of understanding of the nature of Corposol's fieldwork and consequent employee profiles produced the same discord that hiring internally was intended to avoid. The psychologist's criticism of the professional quality of candidates, shaped by criteria not uniformly applicable to this field, damaged both top management's perception of the quality of field staff and loan officers' confidence in their abilities, thus broadening the cultural gap between the levels of the organization.

Although those three positions were satisfactorily filled, because of the less-than-ideal first experience with internal selection, that mechanism was not soon repeated. As a result, the organization hired professionals externally thereafter for positions that might have benefited from an understanding of field operations (and mission). These positions included middle managers in the areas of client training, credit, organization and methods, and administration, many of which could not operate as effectively without an understanding of the characteristics and idiosyncrasies of Corposol's clients, methodology, and mission.

At the same time, some Corposol loan officers were promoted to central-office positions without a formal process, causing some resentment on the part of other loan officers who were frustrated by their perception of arbitrary favoritism. It is important to note this reaction, independent of whether the employees promoted by this means were the most qualified. The choices may have been clear (and correct) for management; yet, the perception of a lack of transparency or fairness can cause dissatisfaction among other staff.

In recognition of the need to continue to explore alternatives, the Human Resources Department began to develop a new strategy for internal selection in 1994. The department designed and implemented a series of internal competitions for positions including organization and methods, client training, and personnel training in June 1994; the previously mentioned *curso concurso* for branch managers in April 1995; and Finansol credit administration in August 1995. These competitions included, in addition to interviews and reviews of experience, exams and other activities to assess the candidates' concrete technical skills and potential.

This approach had a number of positive results. Selected candidates felt good about their positions, as they had worked to win them and were chosen on merit. This created a sense of ownership and motivation not seen to the same degree in loan officers assigned to central-office positions to which they had not necessarily applied. At the same time, the competitive process left no room for resentment on the part of candidates who were not selected, as the process and criteria were clear and managed by the Human Resources Department (which itself had arisen from their ranks), rather than by general management (whose personnel decisions in the past had at times been perceived as arbitrary).

It is important to note, however, that while well received, the positions filled through the processes mentioned above represent only a small portion of the total hiring that occurred during the same period.[82] Other positions were filled through a combination of external selection and autonomous appointment by management. Thus, an element of uncertainty remained for staff, despite clear progress toward transparent middle management formation.

Support for Professional Development

Externally Hired Staff

Although professionals hired from beyond the organization for managerial, staff, or back-office functions ostensibly brought their key job skills with them, in some cases these could be considered only part of the skills they needed to do their jobs. New employees were given an introduction to the organization, but functionally specific training (with regard to the nature of critical responsibilities) usually occurred on the job. This could leave a gap

[82] These positions were all the responsibility of the human resources manager. Had she been granted a broader scope of effective authority, she might have implemented a more comprehensive shift toward internal competition for promotion.

between a new employee's conceptual understanding of the mission and vision of the organization and his or her concrete operational knowledge of the nature and functioning of field operations. This gap precluded optimal central-office support and administration in many functions.

For example, had externally hired staff (1) been sufficiently indoctrinated in the informational needs of loan officers in order to tailor databases and reports; (2) been made to understand the functioning of the credit process as an input for designing appropriate policies, procedures, or organizational designs; or (3) been made to understand the consequences for clients of a late disbursement as an impetus to improve back-office processes, they might have enjoyed greater operational efficacy. Worse, from about August 1995 on, staff other than loan officers received no orientation other than the pre-orientation given as part of the selection process. Management argued that there was no time for further training, prioritizing immediate concerns over longer-term stability. Staff explained that this lack of orientation to Corposol itself further diluted the organization's culture and affected employees' performance and morale.

Internally Promoted Staff

The study team interviewed several current and former staff members who had been promoted internally from loan officers to central-office positions. The team asked the individuals about their experiences in progressing through different positions within the organization, their previous experience relevant to their new positions, the level of support they received from the organization in developing any new skills required, and the degree to which they felt prepared to assume their new responsibilities. Experiences varied in form and results:

- In many cases, especially those involving back-office positions, even staff with no previous experience related to their new positions reported receiving little or no support or job-specific training. Many also cited little tolerance on the part of management for the resultant learning curve. In not a few cases, employees given responsibilities for which they were not trained did not meet expectations and were fired within a few months.[83] This represents tremendous costs to the organization in terms of the time and money personnel turnover entails, including investment in the selection process, loss of productivity in transition, and the drain on good loan officers, to name only a few.[84]

- In some cases (for example, organization and methods), an employee was promoted internally to work with a specialist who had been hired externally. This complementarity was constructive in multiple ways. First, it married technical skills with knowledge of

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[83] These included even people put in very new positions, such as good loan officers sent to Mercasol administrative positions, in which their knowledge of the field was insufficient to prepare them for new responsibilities such as material inventory, negotiations with suppliers, and demand assessment. Needless to say, such employees, without training, were not among the successful cases of internal promotion.

[84] Note that loan officers who did not meet expectations in central-office positions were not returned to their branches but rather were dismissed from the organization.

microenterprise, a feat not accomplished in many positions. At the same time, it offered the opportunity for informal, collaborative staff development, as a technical specialist could provide professional mentoring and support skills development to a former loan officer while learning the fundamentals of field operations. This was the most effective structure observed from the perspective of staff development.[85]

- In a few cases, generally involving management-level positions in the central office, lip service was given to training professionals assuming positions for which they were completely unprepared, as in the case of the human resources manager. This took the form of brief courses or seminars, but staff explain that these were neither adequate preparation nor sufficiently prioritized by top management.

In all cases, the organization relied heavily on individual initiative, effort, creativity, and resilience rather than structured support for new skills development. This style is analogous to the one that drove the process of branch and lending expansion, with a similar result: varied performance. As in lending, with a more structured process and more conscious investment in development of an effective administrative layer, Corposol might have achieved better operational efficiency and quality control. More important, though an indirect driver of the crisis, weak middle management represented a critical organizational deficiency. Branch-level middle managers failed to curtail the deterioration of the field operation, and central-office middle managers failed to provide essential checks and balances because of their insufficient influence in advancing good initiatives and limiting bad ones.

Organizational Design

The organizational design of an institution orders its efforts. The definition of roles, responsibility, and authority; the clarity of communication and decision-making channels; the relationship between operational and administrative functions; and the mechanisms put in place for ongoing management of these and other elements of the organization all shape the efficiency and efficacy of operations. This section analyzes the evolution of Corposol's structure and functioning from its inception as Actuar Bogotá, with an eye toward the role Corposol's design played relative to the organization's growth-management challenges.

Actuar Bogotá

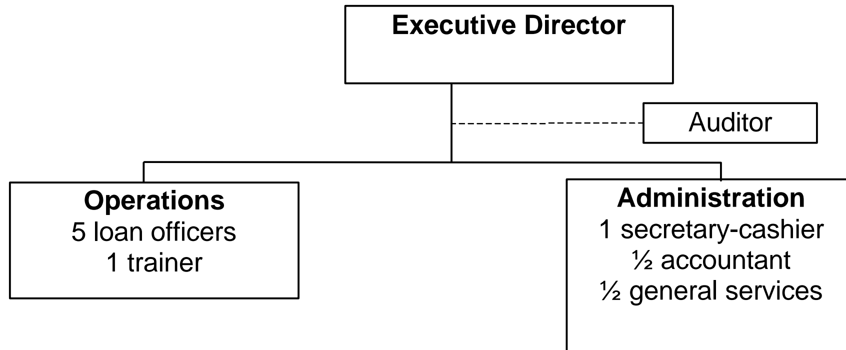
Structure

Corposol began operations in 1988 with a minimal, operations-oriented structure. The founder started with three loan officers, and by the end of the year five officers and one client

[85] Unfortunately, this was not a common situation. In general, Corposol did not make as much use as it might have of teams that could have permitted such combinations of skill sets and exchanges of ideas between internally developed and externally hired employees.

trainer were supported by administrative staff including a secretary who doubled as a cashier, a part-time accountant, a part-time "general services" person, and an auditor. There was minimal hierarchy (Figure 10), as the executive director supervised all personnel.

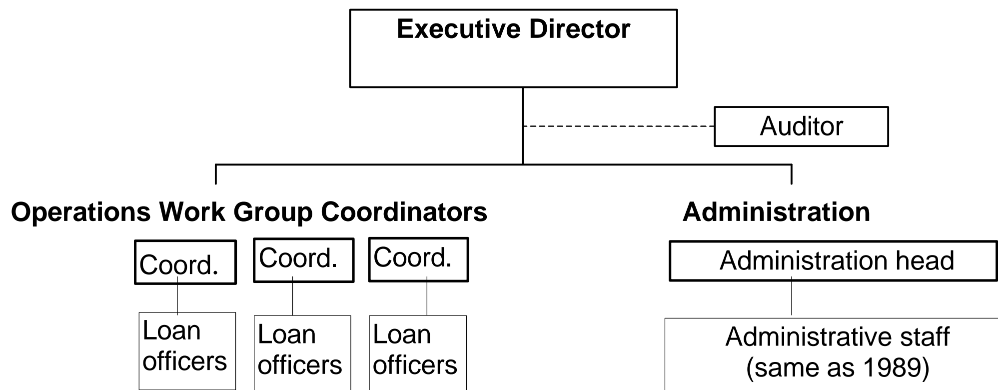
Figure 10: Initial Organization of Corposol, 1988



The following year, this structure remained the same. The operations staff grew to 21 loan officers plus a trainer, while administrative support staff added only a treasurer and an assistant who helped prepare disbursements. This brought loan officers up to 75 percent of the total staff, representing significant economies of scale gained from 1988 to 1989.

As a function of this increase in scale (Figure 11), 1990 brought the first new layer to the existing hierarchy. This new level grew from existing operational and administrative staff as a natural outcome of the need to organize growing numbers:

Figure 11: Organization of Corposol, 1990

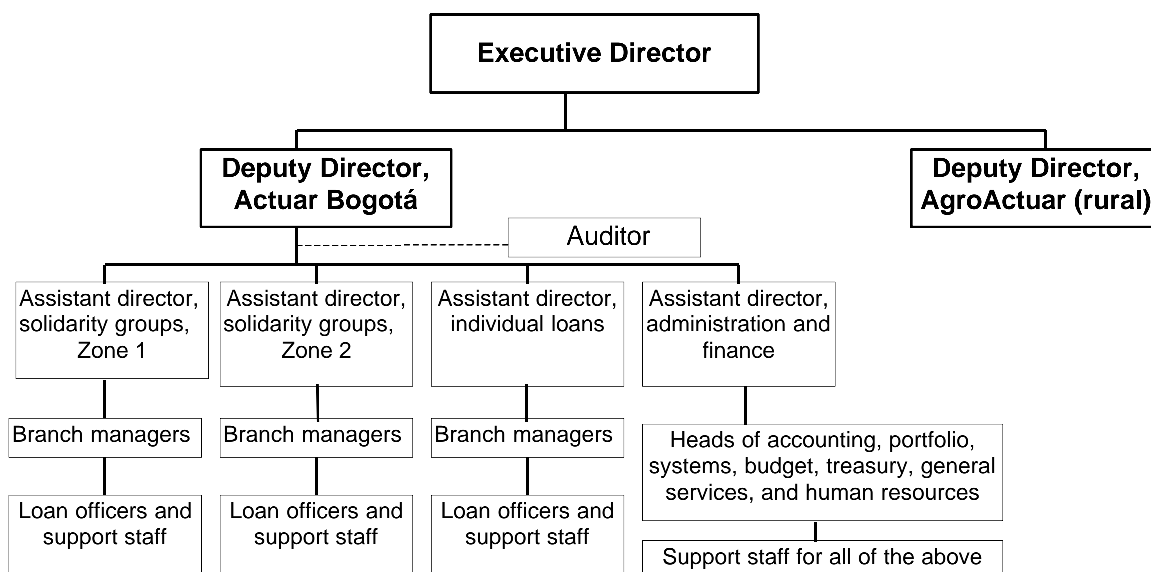


Field-level work group coordinators still managed groups as well as supervised staff; thus, while helping to provide structure to the field operation, they remained primarily productive rather than purely administrative in nature. These three coordinators were also used to support a functional split in lending operations: two of them continued to support solidarity group lending, while the third focused on developing an individual loan program. Loan officers grew to 24 while the increase in administrative support was minimal, thus retaining a high level of efficiency (73 percent of total staff).

Actuar maintained a similar structure in 1991 but added a series of support staff in information systems, client training, cleaning and cafeteria work, and secretarial functions. In addition, the former figure of "work group coordinators," which had applied when all operations were conducted from the same office, translated to branch managers as new offices were opened. Although field staff grew by 75 percent to number 42 by year's end, their numbers declined to 55 percent of total staff. This was part of a phase of expansion that had begun in 1990. By the end of 1991, Corposol had four offices and was poised to continue to grow. This investment in expanding the organization's structure in order to permit further growth is evident in the fact that operational costs as a percentage of average portfolio grew from 36.6 percent to 40.4 percent during that year.

The first significant addition of layers to the hierarchy occurred in 1992 (Figure 12). Not only was an additional supervisory layer added to field operations in the form of regional managers, but more important, two deputy directors were put in charge of the urban and (incipient) rural programs between the executive director and the operational and administrative functions.

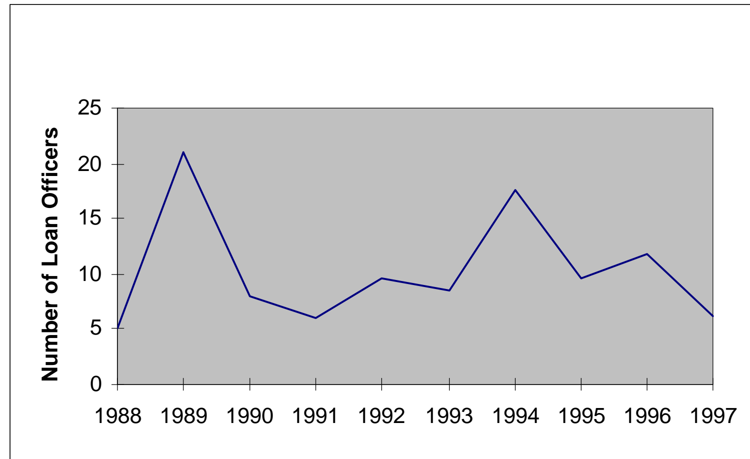
Figure 12: Organization of Corposol, 1992



The administrative support personnel also proliferated during this period, and field operations continued to grow. (See Annex B for a complete set of organizational charts.)

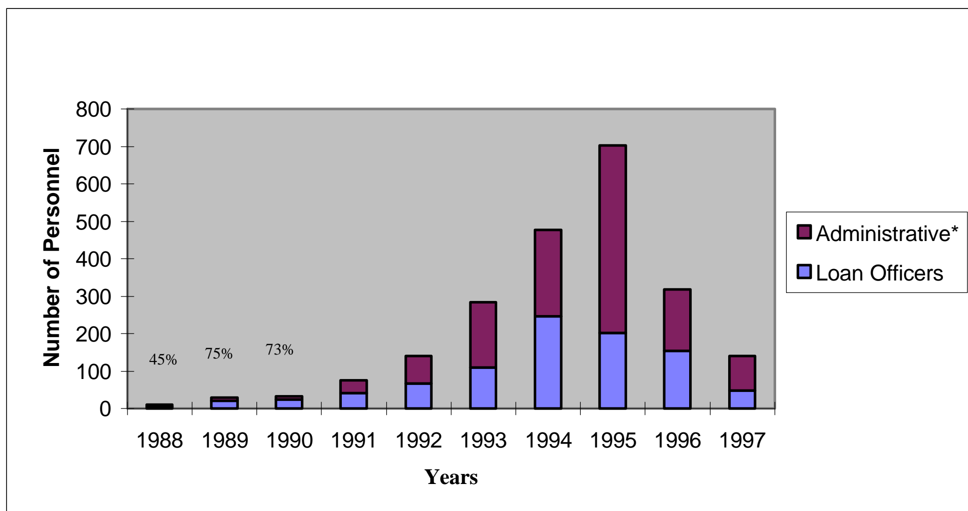
By the end of 1992, the 67 loan officers amounted to only 48 percent of total staff. At that point, the organization had 13 offices. Figure 13 shows the average number of loan officers per branch as it varied over time. Although there were moments of peak load, these were subsequently eased by further expansion.

Figure 13: Average Number of Loan Officers per Branch



During 1993, the general structure remained the same, but additional layers of back-office support were added within Administration and Finance and both the urban and rural field operations. The proportion of loan officers declined still further to 39 percent in 1993, despite the fact that their numbers had grown by 64 percent to 110 (see Figure 14). Despite this shift, as portfolio grew, administrative costs as a percentage of average portfolio declined to 31.35 percent by the end of 1993.

Figure 14: Composition of Personnel over Time



** Administrative personnel include trainers, back office staff, management, etc.*
Percentages indicate number of loan officers relative to total personnel.

Functioning

From the beginning, decision making and authority were centralized in Corposol. In the first years, as noted previously, there was little hierarchy, and staff describe many processes related to the development of the organization or operations as participatory. The founder,

later the executive director, was integrally involved in all aspects of zone development, coordination among staff, planning, and supervision. This was facilitated by the fact that operations were conducted from a single central office.

When operations began to expand, additional responsibility was vested in the loan officers, who became the aforementioned coordinators. This entailed increased independence in functions such as hiring and staff development and zone management. Ultimate authority for significant decision making still rested with the executive director, but the coordinators describe the communication as multidirectional, and say they believe their field input was valued just as they received valuable input from their leader. Staff have described their team in this phase as similar to a small family.

It is important to note, however, that even in this period, certain functions were never decentralized. The establishment of performance objectives, budgeting, and the reporting of operational and financial statistics were always controlled by the executive director. As described in Chapter Three, employees were frustrated by the autonomous way in which their leader set goals. Moreover, former coordinators who were privy to both branch-level and central-office operations recall even then being puzzled to see operational statistics in reports to third parties that reflected numbers that differed from those they had presented. The authoritarian structure made it difficult to question their leader, however.

Another important characteristic of Actuar/Corposol's operations that set the tone for the future of the organization was procedural informality. During the period in which all staff learned about operations from the same source, consistency was easy to correct in a single central office through hands-on leadership. In fact, limited bureaucracy to permit flexibility and agility was considered a virtue in the perpetual drive for operational efficiency and productivity in lending. As such, very few policies, procedures, or norms were written down or institutionalized. Rather, operational parameters were discussed in meetings between the executive director and coordinators (later, branch managers), and from there changes were disseminated to loan officers. Consistency in operations became the responsibility of each branch manager.

When asked about a credit policy or methodology manual, most staff interviewed insisted that one never existed. A few recall norms being established through memos from the executive director once staff were distributed among different offices, but they remember that these norms changed frequently. Others explain that an attempt to formalize procedures began when the initial training process became more comprehensive, but with the caveat that what happened after training was a function of the supervisory "style" of each branch manager. One professional commented that he was not sure staff would have read and adhered to a manual even had one existed, because of the implicit prioritization of ends over means perpetuated at the branch level.

Despite the lack of written policies, procedures, and norms, most current and former staff interviewed argue that lending standards were still reasonably consistent as long as enough experienced staff in relation to new staff permitted continuity in training and supervision. The experience thereafter is discussed further below.

The Corposol Holding Company

Corposol's structure and functioning assumed a new set of dynamics upon the creation of the holding company. From an organizational perspective, one of the essential questions is whether collectively the holding company could be considered greater than the sum of its parts. This section discusses Corposol's efficiency, functional integrity, and adequacy relative to growth as a means of assessing the degree to which the holding company added value through scale and synergy or, on the contrary, became a net burden to its components.

Efficiency

Growth in Structure and Composition. In April 1994, Corposol announced its holding company structure change to employees. The holding company was composed of a combination of what were to be for-profit businesses and not-for-profit programs, which together were to pursue Corposol's vision of integral development (see Chapter Two).

Each component of the holding company had its own leadership, yet all were subject to the direct control and decision-making authority of the president of the holding company, the former executive director of Corposol.[86] Each entity had its own vertical hierarchy, and little structured horizontal integration or communication existed between the components. The primary thread linking them was the fact that in general they were serving the same client, although even this did not always spark an orchestration of efforts.

This structural change, in combination with the addition of new initiatives and the ongoing growth in existing field operations, produced an increase in total personnel of 68 percent from 1993 to 1994. Although the number of loan officers grew by 123 percent, thus representing a significant contribution to the number of total staff, this does not detract from the fact that 58 new employees who were not loan officers entered the firm during 1994. These employees pertained to both operational and administrative functions for the new initiatives and the holding company itself.[87]

The organization's dramatic growth continued in 1995, with total personnel increasing another 47 percent to 703.

The organization's operational efficiency improved slightly from 1993 to 1994, with operational costs equal to 31 percent of average portfolio. However, by 1995, they were up to nearly 34 percent. This was even higher than 1992 levels, suggesting that even at its peak of lending, Corposol had invested in capacity that was underutilized. In fact, from a high of

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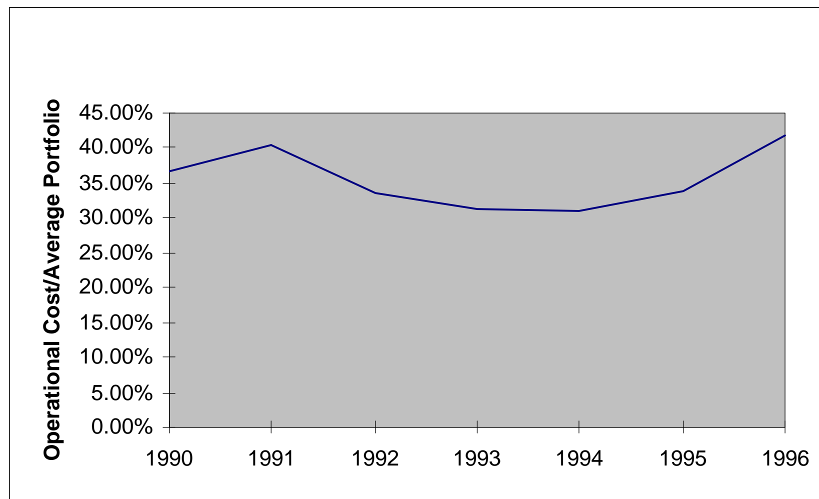
[86] Although Mercasol and Finansol had their own boards, both were majority-owned by Corposol and as such shared many participants, named by Corposol. With hindsight, such a dominant role by an institution that retained its NGO culture in two for-profit entities had a debilitating effect on the governance structure.

[87] It is important to note that this increase by and large is not attributable to additional staff hired with the establishment of Finansol, as the CFC began operations in November 1993. Consequently, while the increase may include some additional staff hired for Finansol, other new initiatives, such as Mercasol, claim a much larger share of these new hires.

190 clients per staff member in 1991, this increase in holding company personnel lowered the ratio to only 65 clients per staff member, representing a decline in operational efficiency. Later, in 1996, as the portfolio declined and before the organization downsized to a corresponding degree, administrative costs as a percentage of average portfolio rose to almost 42 percent, the highest in the organization's history (see Figure 15).

Figure 15: Administrative Cost of Portfolio



One benefit of a holding company structure is that it presents the whole as the sum of its parts, focusing attention on the success of the whole, rather than on the strengths and weaknesses of individual components. In Corposol's case, however, this ultimately became a critical flaw. In an attempt to better understand the pros and cons of the holding company's internal structure, the following sections address the degree to which the organization gained or lost efficiency in the management of its staff functions; how the new structure affected the organization's primary business of lending; the ramifications of blending a regulated financial institution with nonregulated, nonprofit entities under the same umbrella; and other structural characteristics of the organization that ultimately weakened its functioning.

Shared versus Redundant Support Functions. In theory, the holding company was to centralize those support functions that did not require specialization by component, or that should have been provided from a single source to permit cohesive functioning of the holding. Such functions, or departments, included Human Resources, Organization & Methods, and Information Systems. Other functions unique by nature to a particular component were to be managed independently by each. These included the treasury operations to secure funding in financial markets for Finansol, the solicitation of donations for the Corposol nonprofit programs, and accounting for the businesses independently of the programs, for legal purposes.

Over time, however, the trend was toward decentralization of even some functions that could have been shared, perhaps in part because of the desire for self-determination by the management of certain components, together with the fact that the operational independence

of the entities made it difficult for a central unit to fully meet the needs of all the parts. This is best illustrated with the following boxed and bulleted examples.

- Some decentralization occurred because even central Corposol management at times acted independently rather than thinking for the whole of the holding company. For example, in early 1995, management contracted the consulting firm Talento y Estratégia to revise the existing salary curve, definition of functions, and structure of Corposol. These issues were critical to other entities of the holding as well, and in fact should have been analyzed in their aggregate context to permit development of recommendations coherent for the whole organization. In the absence of a comprehensive study, however, Finansol management spoke of commissioning its own study, as it felt its needs had not been taken into account.[88] Such experiences deepened the sense of division between the components of a supposedly unified organization.

- Other shifts toward decentralization followed. The Organization & Methods Department was created for the holding company, but after some initial joint projects, the department's staff were split between Corposol and Finansol, while Mercasol planned to meet its organizational needs itself. Although the relations between these staff members remained good, their work became independent, which may have represented an additional forgone opportunity for cohesion within the holding, as unified policies, procedures, norms, structures, and processes could have served as the mortar uniting the various parts of the organization.

The Genesis of the Human Resources Department

The Human Resources Department was established in April 1994 around the time the holding company structure was put into place. At that time, the department was intended to provide personnel selection, personnel training, and benefits to the entire holding. Difficulties with this strategy, however, arose as a function of deficiencies in communication, coordination, and planning between entities. For example, the efficacy of the selection function was contingent upon information received about the numbers and profiles of staff required by each entity. When requisition forms were submitted with urgent timeframes rather than as a function of periodic planning, the central department became a bottleneck. Worse, when the desired profiles for new positions were incomplete, it was more difficult for a centralized department, unfamiliar with the specifics of each entity, to know for what to look.

Later, in addition to these difficulties, managers in some of the entities began to feel that having the human resources function centralized in Corposol restricted their autonomy by controlling personnel decisions. Moreover, despite the intentions of the Human Resources Department, staff in areas beyond the immediate Corposol umbrella felt they did not receive the same services or treatment as Corposol staff. As such, both Finansol and Mercasol created positions to manage their own human resources functions.

Beyond this functional evolution toward decentralization, there appears to have been some unnecessary duplication of functions. Organizational charts for Corposol, Finansol, and Mercasol all feature functions such as "general services" for items including office supplies, cleaning services, messengers, and so on that might have achieved some economies of scale

[88] That never occurred, however, because of the onset of the crisis.

had they been managed centrally for all entities of the holding.[89] At least part of the downsizing in staff between 1996 and 1997, when the holding company was streamlined back to a primary credit operation in the form of Finansol, was an elimination of redundancy in support functions.

In some cases, although decentralized management was necessary, the lack of integration between components had ramifications for loan officers, whose fieldwork with clients put them at the intersection of the services provided by each entity. The inability of Information Systems to support the idiosyncrasies of both geographic expansion and product diversification without sacrificing the potential for consolidated portfolio management is a good example. The implications of this dysfunction are discussed further below.

Similarly, because payrolls were handled independently in Finansol, Mercasol, and Corposol, discrepancies that already existed in the salary curve became more widespread, and the ambiguity between some functions and lines of authority was compounded.

In short, although some efficiency gains may have been achieved through the creation of the holding company structure, had such gains been the primary motivation behind the structure, more effort would have been made to realize them. As it was, over time, the components of the holding desired more autonomy, developing their operations independently where possible and rendering the holding company structure more artificial than unifying.

Credit Approval in Finansol

The struggle over credit approval went through many phases before Finansol became independent from Corposol in mid-1996.

- Finansol management's original plan was to approve loans via a central committee composed of the managers of Administration and Finance, Operations, and Credit. Yet, the standards of that committee were so different from those of the Corposol loan officers that at one point, no credits were disbursed for a week until agreements could be reached.
- The attempt to centralize approval also created an administrative bottleneck, because of the sheer volume of lending at that time. As such, after a month, the committee decided to review a sample of about 10 percent of the applications submitted, as a means of maintaining some control, but even then, basic steps such as verifying potential clients' credit with other institutions or checking references were sacrificed. Finally, in about March 1994, Credit staff recall, revision of loan applications was given up altogether as "unmanageable."
- When that approach was abandoned, Finansol management put forth another initiative in an attempt to have greater participation in the credit process. In March 1995, it introduced the concept of "credit analysts." Finansol hired a group of analysts whom it assigned to each branch, with the idea that they could review loan officers' credit analyses and participate in credit committees, thus giving Finansol a role in decentralized loan approval. The concept was interesting but failed in its execution. Unfortunately, regardless of their previous experience, many of the externally hired credit analysts were unfamiliar with the field. Consequently, they had little technical credibility with experienced loan officers and were resented for their attempts at "oversight." As a result, this strategy was discontinued shortly thereafter, and the Finansol analysts were incorporated into the general loan officer pool.

[89] In discussions of the organization, "Corposol" includes, in addition to the administrative functions for the holding company, the functional units of client training, Construsol and Agrosol.

Functional Integrity

Credit Operations. One aspect of the initial structure of the holding company that had problematic consequences was what amounted to a disaggregation of responsibility, authority, and accountability in the credit process.

On the grounds that the loan officers would serve as the primary interlocutors between the client and Corposol's many services, it was determined that they should remain staff of Corposol. They would evaluate clients' creditworthiness and debt capacity, advise them with respect to training alternatives, and offer the possibility of additional credit lines, such as Construsol or Mercasol, when appropriate. Under this scheme, Finansol's role would be limited to the provision of financing. This was to include Finansol's responsibility for funding itself in the financial markets, loan disbursement, and portfolio management for purposes of reporting to the superintendency.[90]

At the time, this was considered a benefit of the holding company structure, in that it alleviated the need for the fledgling CFC to assume the full, up-front cost of maintaining a field staff while working to build a financially sustainable scale of operations.[91] Rather, Finansol could pay Corposol a "client management fee" for the services of its loan officers, which amounted to a variable cost based on volume, much easier to cover during a start-up phase.[92]

Although clients may never have noticed a change in service, this division of labor created confusion and conflict among staff from the beginning. Finansol staff, recognizing the entity's public responsibility to the superintendency for its portfolio quality and lending practices, felt they should play a role in loan approval. Corposol staff, accustomed to an agile, branch-level approval process, resisted the imposition of what they saw as an unnecessary administrative layer and standards inapplicable to their clients. The same occurred in the management of arrears: Finansol bore the responsibility for loan delinquency yet had no authority over loan officers who were in the position to follow up on client repayment.

This structural division was exacerbated by a clash in operational mindsets, which emerged with the birth of Finansol and its first management team. On the one hand, Finansol management had a valid concern about portfolio quality, which had not been as pressing for Actuar as an NGO. Namely, the institution needed solid financial performance in order to survive, and provisions for portfolio at risk had a direct effect on the institution's bottom line.

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[90] One staff member joked that Corposol's president had turned Finansol into a checkbook for the holding company.

[91] Later, a disadvantage for Finansol became clear: retention of field staff, combined with an inappropriate incentive structure, gave Corposol another element of operational control inconsistent with Finansol's responsibility for the performance of that staff.

[92] In actuality, this never occurred. It had been agreed that Corposol would not charge Finansol a fee for the initial months during the latter's start-up, but this grace period was continually extended. In early 1995, Finansol made some token payments for a few months, but the transfer price did not reflect a real valuation of the cost of service provision. After a few months, the small charges were reversed, as a "contribution" by Corposol to Finansol. This became one of the crutches that hid the true financial condition of Finansol.

In this sense, its desire to play a role in controlling portfolio quality is understandable. On the other hand, experienced staff from Corposol felt that the Finansol bankers who questioned their lending decisions failed to understand the nature of microentrepreneurs and the idiosyncrasies of microlending (see "Credit Approval in Finansol," in box). They questioned the technical criteria of the Finansol staff, and resented what they considered to be a barrier to their productivity and their clients' satisfaction. This initiated a lasting conceptual clash between the two staffs.

One large dilemma throughout this period was the fact that the institution still had not formalized its credit policies or procedures governing internal authority structure. Thus, when differences of opinion occurred between Corposol and Finansol, it was unclear whose view should take precedence. Finansol was left in the uncomfortable position of being technically responsible for the results of procedures beyond its control, and subject to the authority of Corposol, its majority shareholder. (This dilemma over the supervision of a regulated financial institution by an NGO is discussed further below.)

Another complication that arose from the artificial split of the credit process between Corposol and Finansol was the generation of certain operational inconsistencies. For example, in certain branches Finansol placed cashiers to receive client payments.[93] Although technically money should only have been received in those branches (because the Finansol cashiers were subject to controls and specific security regulations), many clients and loan officers saw little difference between these branches and the others. In the absence of a formal policy to eliminate this ambiguity, and in the context of intense pressure to recuperate loans, staff received payments at all the branches. Unfortunately, both fraud and robbery occurred in Corposol branches that lacked the appropriate security mechanisms until "cleanup" measures were introduced at the end of 1995.

The division of authority and responsibility in the credit process created ambiguity for staff as well, which contributed to both frustration and sometimes lapses in performance. One manager from a branch outside the city recalls being a Corposol employee but reporting to a supervisor from Finansol because of the geographic location of the branch. She relied upon Finansol staff for support and information to do her job, and her Finansol supervisor was the most familiar with the nature of her work. Yet, her salary, budget, hiring authority, and official support structures were to come from Corposol. Given Corposol management's lack of understanding about her branches' operations, she felt her needs were never met. Eventually she joined others who left the institution because of their frustration.

Over time, even the superintendency questioned the logic of this split in the credit process, adding weight to the arguments of those who had supported the importance of Finansol's

[93] For many years, Corposol maintained a relationship with the Banco de Bogotá to offer its clients the convenience of multiple locations for repayment, complementing its own cashiers in the central office. Unfortunately, Corposol clients did not always feel they were treated on par with other clients at the formal bank. Moreover, there was a time lag in information received from the bank about client payments, complicating follow-up on delinquent loans. As such, in 1995, Finansol began in earnest to place cashiers in its branches. Given the problems experienced, it is surprising that the cost/benefits were not assessed earlier. However, they were not formally analyzed prior to the change of strategy.

independence all along. As such, the decision to initiate a transition process was made in mid-1995, and all loan officers formally pertained to Finansol as of March 1996.[94]

Unfortunately, some of the confusions resulting from the institutional division of field operations persisted even after the transition of loan officers to Finansol. For example, a diagnostic of the status of field operations as of May 1996 detected a different inconsistency that resulted from the divided structure. The client trainers at that time still pertained to Corposol, and in some branches they related to loan officers as if a "divorce" had transpired. Given the direct link between lending and training in Corposol, a lack of communication between the agents of these two elements could have had serious consequences. For example, loan officers who continued to promote technical training alternatives with their clients without being aware that the trainer had no intention of offering those courses in the immediate term unwittingly contributed to a client satisfaction problem. This "divorce" was not universal, but in the branches where the relationship still functioned well, good relations were a function of individual initiative rather than of an institutional strategy to address such structural gaps.[95]

As the discord grew, Finansol strove to attain its operational independence, to the point where, in March 1996, in order to cut off staff interaction completely, Finansol's president ordered officially sealed the door dividing the office space occupied by Corposol and Finansol personnel. In June 1996, the portfolios and operational ties of the two institutions were officially divided, in part to insulate Finansol from the impact of Corposol's impending collapse to the degree possible.

In short, despite the logical arguments put forth for Corposol's retention of field personnel upon the creation of the holding company, experience shows that an unnatural division of the credit policy created an unfortunate combination of inefficiency because of duplicated effort; dropped balls because of unclear assigning of responsibility; and resentment among employees because of resultant ambiguities. This structural division of responsibility, authority, and accountability was a direct contributor to the snowballing deterioration of Corposol's portfolio quality.

Integral Management. The manner in which Corposol managed the relationships between its for-profit components and the not-for-profit holding company initially protected the apparent performance of the group but ultimately proved to destabilize critical operations.

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[94] Given the logic of unifying responsibility and authority in the credit process, one might question why the transition did not occur earlier. One justification put forth is that Finansol still had not achieved the desired levels of financial self-sufficiency, a situation that would have been exacerbated had Finansol had to assume the full costs of the field operation. Some argue, however, that the president of Corposol resisted relinquishing field staff, a central locus of operational control, until his own cash-flow crisis allowed him no alternative.

[95] Other current and former employees also cited experiences reflecting this ambiguity. As the roots of the crisis in Corposol strengthened, so too did the animosity between Corposol and Finansol. This began to hinder operations at all levels, as it affected who was paid and intensified loyalties.

There were times when the ability to work through an affiliated, nonregulated entity was a boon to Finansol, as it was able to avoid government regulations. For example, when the superintendency limited the lending growth of financial institutions in 1994, Finansol could still issue loans through Corposol, thus avoiding interruption or limitation of client service.

The Corposol "crutch" became a vice, however, in the sense that management of the flows between the two institutions made it possible to mask the true performance of Finansol. When the portfolio began to deteriorate, for example, the worst loans were restructured and sold to Corposol, whose portfolio was not subject to provisioning requirements or review by the superintendency. Such maneuvers were at best temporary fixes, however, and signified the bad habit of hiding behind an NGO to avoid playing by the rules, which kept Finansol from developing operational standards with the required rigor. At the same time, the fact that Finansol did not have to bear its own full operational cost (as loan officers were supported by Corposol until 1996) helped to camouflage Finansol's true financial condition.

Finansol's integral relationship with Corposol proved to be a double-edged sword, in the sense that its management did not have the full autonomy to make objective decisions consistent with the responsibilities of a regulated entity. Beyond the ambiguity of authority and responsibility in the credit process, this dynamic also drove strategic decision making for the holding company. For example, when Corposol's visionary president hatched his ideas about integral development, in his view launching them via the lending branch of the holding company probably seemed a logical strategy. Yet, one might ask whether Finansol's president, if given the independence to choose, would have elected to diversify his portfolio so rapidly with untried products. The fact was, however, his primary shareholder, and therefore leader in governance, was an NGO, whose president also happened to be his direct operational supervisor. This fact, in combination with Finansol's effective dependence on Corposol, limited the possibility of autonomous decision making.

This was compounded by the fact that the Finansol board was structured in such a way that it never played the role in governance it should have. There was no rotation of the presidency of the board, as the position was always held by the original backer of Corposol's president. The backer, in turn, could not be said to have had an arm's-length relationship with the president of Corposol. Rather, their daily meetings testified to the degree of involvement that at times might have reduced the board president's capacity for independent oversight. Moreover, Corposol's majority ownership led to a board almost entirely composed of supporters appointed by the president.

As late as 1996, despite the fact that Finansol in theory had full responsibility for the credit operations of the holding company, the president of Corposol was in the process of selecting a "portfolio manager" who was intended to play a joint role for Corposol and Finansol. This demonstrates the ongoing lack of autonomy of Finansol. The person was never hired, however, because of Corposol's dissolution.

Gradually, Corposol began to lean more heavily on Finansol in an attempt to dig itself out of the deepening hole of crisis, as reflected in the following turn of events.[96]

- In December 1994, Finansol disbursed to Corposol the first half of a C$600-million (about US$723,000) rotating line of credit with a one-year term, at a preferential interest rate.[97] Unfortunately, when Corposol's balance-of-payments crisis hit, it could not make good on its obligation to Finansol.

- In 1995, Corposol used Finansol to purchase real estate, with the argument of needing a large, fixed asset to offset inflationary adjustments for Finansol's portfolio. Only after the fact was it determined that this unproductive asset was far larger than would have been necessary to achieve the desired adjustments, and that Finansol had financed the purchase via expensive, short-term borrowing. Later, some questioned whether the investment in fact represented speculative behavior on the part of Corposol. After a decline in the Bogotá real estate market, the property was sold at a loss of about C$1 billion (just under US$1 million).

- When strapped for cash in 1995, Corposol sold its assets to Finansol in order to receive a capital injection. There was no independent professional valuation to back the terms of this transaction. The Finansol board was informed of this decision after the fact. Thereafter, Corposol "leased" space and other assets from Finansol.

- While the field operation was still under Corposol, there was a period when Corposol branches retained client payments they collected on Finansol loans rather than forwarding them to Finansol. This resulted in a level of accounts payable that at one point exceeded legal limits for shareholder debts to a financial institution, a violation observed by the superintendency.

Beyond integral financial management, Corposol created an operational dependency on the part of the entities of the holding company. Construsol, for example, could not exist without the holding's loan officers and Finansol's credits. Agrosol, too, depended on Finansol's lending facility. Similarly, Mercasol could not exist without financial infusions from the holding. As noted above, Finansol could not have existed independently either, as it could not have borne the full cost of the field operation sustained by Corposol. The holding company itself received a substantial percentage of its income from training fees, which were tied to lending. Moreover, all of the entities depended on clients to exist and were subject to the fact that their image in the market was integrally linked to, if not synonymous with, that of Corposol, which had been the center of all promotional efforts.[98]

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[96] These examples occurred under the tenure of the first president of Finansol, whose ability to act independently was clouded by his long-standing personal and professional relationship with the president of Corposol.

[97] Finansol board members were told that this loan was within allowable limits for such *créditos vinculados* (insider lending). However, later that limit was surpassed.

[98] It bears noting that much of the publicity for Corposol was provided by the president of its board. The fact that only the Corposol image had been promoted in the market later proved a source of confusion for clients and even an impediment to repayment once Corposol and Finansol were severed and Corposol was closed.

Although such a structure was conceived of as mutually supportive, it also nearly guaranteed a domino effect in the case of difficulties. Given that risk, one might question the wisdom in subjecting two private, commercial entities (and, in particular, Finansol as a regulated financial intermediary) to primary governance and operational control by an institution whose management retained an NGO mentality about businesses practices.

Structural Weaknesses. During and after Corposol's crisis, evidence of both mismanagement and fraud came to light at multiple levels in the organization. Although no organization has complete control over the integrity of its staff, Corposol's experience suggests that structural considerations exist that can create or preclude such undesirable behavior. This section discusses such weaknesses in the Corposol holding company.

One of the most basic variables that can affect operational integrity is the efficacy of support and control systems throughout the credit process. Whether manual or systematized (either can be very effective), regularity in the functioning of such systems, their timing, their participants, and supervision all affect the degree of "give" in the process, the consequent strength (or lack thereof) of internal quality control, and the potential risk of deviation. For example, through late 1995, controls between the time clients made payments and the time payments were reflected in the accounting system were weak, creating a "flexibility" in management. Branches sent manual receipts for money they had received to the central office, where they were processed by hand. Because of the volume, it was common to have a four- to eight-day lag between client payment and accounting verification of funds. During that period, not only was it impossible to evaluate comprehensively the repayment status of loans, but the funds could be in limbo as well. Employees could, and some did, take advantage of these lags in accountability to make use of client monies for other purposes.[99]

Another structural characteristic of Corposol's administration that allowed bad practices to continue, often with the unknowing participation of multiple employees, was the breaking down of administrative processes to the point at which each participant in the chain managed such a small piece that none of them individually was ever in the position to question the process as a whole, or to notice irregular results. One employee compared this process to a series of tiny islands, the inhabitants of which were powerless because of the lack of awareness that together they could have significant force. Current and former staff who performed such functions could describe their routine operation, but they often seemed to have little knowledge of from where the inputs came or for what the outputs were used. Examples of processes in which this appears to have occurred include the solicitation and execution of and reporting on donor-funded projects, and adjustments in accounting for field operations, among others. Even a professional who served as treasurer in 1993 explained that his job, in areas such as liquidity management, was to execute, not define. The mandates for the operations he was to perform came from the executive and deputy directors. Staff who were aware of some of the aberrations explain that there were individuals in key

[99] This particular situation was resolved when procedures were revised and technology improved in late 1995. As of the time of this writing, when branches receive funds, information is sent immediately via modem to the central office, where it is consolidated, reflected in the appropriate accounts, and cross-verified by the Accounting Department. Any discrepancies are documented immediately and followed up with branch and credit managers to restrict the possibility of irregularities.

positions at various levels who did have the whole picture, but that these individuals had been co-opted by management and were directly involved in perpetuating or covering up some of the mismanagement.

Another pervasive characteristic of Corposol's structure that ultimately became a critical weakness was the lack of checks and balances. This had an impact in multiple areas, as illustrated below:

- A treasurer who committed fraud had the leeway to do so because he managed a closed circle – he was the direct and only supervisor of the people responsible for accounting for the transactions.

- Because individual loans were centralized in one branch under a single manager, there were no checks and balances from an overseer or the credit committee. Because these loans were made to individual clients rather than to groups, any irregularities were easier to arrange and hide. These large individual loans were an easy vehicle for manipulation by people at other levels of the organization, too. In fact, according to *El Espectador*, a Bogotá newspaper, uncollateralized loans estimated at "at least C$30 million" (approximately US$30,000) were allegedly disbursed to the president himself.[100] Moreover, delinquent loans currently in the judicial process allegedly include credits given to friends and family members.

- Executive management itself was not subject to sufficient oversight. Despite evidence of the burgeoning crisis, Corposol expenditures still included the purchase of shares of and consumption at an exclusive local club, automobile leases for top management, and postgraduate degrees for some of the president's inner circle of managers. Such expenditures might not have been approved during an economic crisis had top management been subject to supervision by an entity with full information.[101]

- The level of control the president enjoyed continued even through the organization's last days. Despite the fact that many employees had not yet received the salaries and severance pay due them from Corposol, in the last week before Corposol closed its doors, the president paid himself a bonus of C$74 million (about US$74,000).[102, 103] Had management been subjected to a different governance structure, other decisions may have been made with respect to the use of those monies.

In short, the structural weaknesses described above contributed to both the growing instability of Corposol's administrative structure and the delay in detecting them.

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[100] Cited in "Desvían Fondos de Ayuda Internacional," G. Ignacio Gomez and Norbey Quevedo, *El Espectador,* p. 4A. Santa Fe de Bogotá, July 23, 1997.

[101] A partial explanation for what appears to be a lack of governance is that in some cases the board was not given full information upon which to base its decisions. Its members made an assumption of good faith, without awareness that the reports they received from the external auditor were also not as stringent as they might have been. The auditing firm was replaced in June 1996.

[102] As of January 1998, some of them were still awaiting the results of the liquidation in hopes of receiving some of the compensation they were due.

[103] *Op. cit.,* Gomez and Quevedo, p. 5A.

Adequacy Relative to Growth

One paradox in Corposol's development is the fact that management's driven growth strategy appeared to have been implemented with only half of the necessary equation. Management hired loan officers and launched new credit lines to generate lending volume in quest of much lauded economies of scale. Yet, management seemed to have overlooked the possibility that the administrative capacity installed would have a certain limit, beyond which it could no longer effectively support further expansion of operations. The following section discusses some of the deficiencies that arose as a result and their implications.

Guidelines. Many institutions begin and grow with operations characterized by informal policies, procedures, and planning that may be managed flexibly as merited by circumstances or with little documentation. Such systems can be very effective, as long as they are managed consistently in a sufficiently controlled environment. In Corposol's case, once accelerated expansion of the field operation began, such control over consistency was lost. Subsequently, the lack of explicit, standardized operating parameters to guide Corposol's increasingly decentralized lending proved a fatal flaw.

Despite the fact that aberrations in lending standards had begun to surface, no formal attempt was made to develop standardized policies or procedures until July 1995, when a loan officer promoted to direct Corposol's personnel training program took the initiative to begin developing a methodology manual.[104] The project was never completed, however, because of the frequency with which the norms and standards changed, and because of what this professional describes as a lack of management support for the initiative.

Other initiatives had similar ends. The fledgling Organization & Methods Department began to develop a set of operational manuals, in part to satisfy requirements of the superintendency. Some of these processes were supplemented by external firms hired to draft the requisite documents. Yet, these documents were never widely disseminated to operational staff or applied at the field level.[105]

The first true standardization of many policies and procedures consisted of a series of memos from the president of Finansol, written in 1996. These memos constituted a significant stride in laying the groundwork for healthy future lending, but by that time the institution was already paying for its earlier practices.

Preparation. Corposol's approach to strategic and operational planning and analysis suffered a pattern very similar to that described in the previous section. Early in the organization's trajectory, new ideas could be executed in a very agile manner with minimal analysis or planning, as the institution's contained scale permitted simple control and

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[104] He started this process with inputs from the ACCION manuals that had been the seed for Actuar's lending operations, working with ACCION's organizational development director.

[105] In practical terms, the application of policies and procedures is a far more important measure than their existence on paper. The fact that staff interviewed could not remember a formal credit policy means it does not matter whether some administrator has a copy of one on file: Effectively, lending through 1995 had little but informal governance.

management. This practice became harder to execute effectively, however, as both the ideas and the organization grew. The following sections on geographic expansion and product diversification show how Corposol's inadequate development of mechanisms to analyze, prepare for, and orchestrate new initiatives weakened the organization's ability to incorporate change without compromising operational quality.

Geographic Expansion. The process of geographic expansion posed a set of challenges as a function of decentralization that Corposol had not encountered in earlier growth strategies. Operational logistics had to address variables not encountered in the lending program within Bogotá. In addition, the unity of the organization was put at stake for the first time. Corposol did not effectively anticipate or respond to these elements, thus weakening the fabric of the extended field operation in ways that ultimately forfeited any advances initially made via this growth strategy.

One primary weakness in Corposol's preparation for geographic expansion was the organization's failure to complete beforehand critical troubleshooting of logistical challenges. For example, the lack of communications infrastructure and technology in the areas Agrosol served complicated reporting. Consequently, Agrosol adopted a manual procedure, aggregated on a monthly basis, and later maintained it using a simple spreadsheet. Although this system was adequate for Corposol as an NGO, insufficient consideration was given to its adequacy relative to the standards to which Finansol's lending was being held. Agrosol's manual monthly reporting made it difficult to track client payment closely, and the spreadsheet-managed portfolio did not subject Agrosol loans to the same parameters as Finansol's information system controlled. This absence of controls proved a critical weakness.

With misinformation having been reported to the superintendency for two and a half years, the president who took over Finansol in October 1995 discovered serious delinquency in the portfolio, which had always been portrayed as healthy.[106] Provisions for the late loans first hit Finansol's income statement in November 1995 at a cost of about C$300 million (approximately US$300,000). A preparatory approach to avoid such problems by incorporating critical controls earlier might have safeguarded the Agrosol program. Beyond ineffective anticipation of, or planning to address, the challenges of decentralization, Corposol management had a tendency to shift the burden of problem solving to staff. Management relied heavily on the same do-it-yourself sense of initiative from staff that had been the foundation of the urban program. Management did not, however, always recognize instances in which that sense would require additional support to ensure the functioning of operations farther afield. This lack of attention to the needs of very decentralized offices ultimately hurt the quality of service offered from those locales.

[106] One practice was the introduction of a type of "evergreen" loan. Billed as an innovative methodological adaptation to accommodate the harvest-focused cash flow of farmers, evergreen loans were issued with amortization that permitted delayed repayment of as much as 70 percent of principal until the final due date. However, new loans were issued to replace the old ones before the final balloon payments came due, thus hiding the fact that the principal had never been repaid.

- Staff were required to handle the logistics of lending. This included traveling frequently back and forth to Bogotá with loan applications, disbursements, and documentation and shouldering the risk, time, and cost associated with such operations. One might ask whether this was the most effective use of time for branch and regional managers, given their critical responsibility for the consistency of a decentralized field operation. Had Corposol sought other means of logistical support, field-level middle managers might in turn have dedicated their time to supporting and supervising field staff rather than to handling the logistics of loan administration.

- An Agrosol manager recalls the impact on operations in February 1996, when management discovered the rural portfolio problems and began to require daily submission of information. Despite the validity of the new requirement, staff in far-flung rural areas had no easy way to comply, because of limited communications infrastructure in their zones. Although staff requested support, such as a messenger who could collect information from multiple zones to avoid taking loan officers' time away from productive labors, none was forthcoming. One former employee recalls having to abandon a critical technical assistance effort in order to travel to send a fax.[107] "When their cow died," he explained, that *colectivo* "realized they were not really a priority for Corposol. After that, repaying their Corposol loan was no longer a priority for them." As in the previous example, lack of timely support increased the costs of lost loan officer productivity and diminished client service.

Because support for such key logistical areas was not always sufficient, it is not surprising that many other elements that might have helped maintain quality operations also fell through the cracks. The lack of generalized measures to ensure that organizational unity would be maintained during expansion is just one example.

- One manager, asked to open a branch in a municipality outside Bogotá, was told that it would be too costly for her newly hired loan officers to travel to the city to participate in the standard introductory course given to all incoming personnel.[108] This not only placed the entire burden for staff training on her, but also implied a dilution of field staff identification with the organization and its mission, as her loan officers never had the chance to meet other staff, visit the central office, or experience "the dream" of the institution, generally shared during the initial orientation process.

- Staff explained that management's responsiveness was often conditional: Branches that showed results received support, while those that did not meet expectations were ignored. Although such a principle may be merited in a system of rewards and penalties, withholding further support when the lack thereof could contribute to low performance is not the most direct means of correcting the problem. This "survival of the fittest" norm

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[107] Agrosol technical assistance could include essential, time-sensitive support in animal health and breeding and other critical areas.

[108] This practice was not uniformly applied; rather, it seems that in general new Agrosol loan officers participated in the standard orientation process in Bogotá. Even if this was the only office where such a decision was made, such an inconsistency in standards could have caused confusion and disillusionment among staff.

applied by management produced a downward spiral in branches that otherwise might have become productive operations. Essentially, the investment in some branches was never given a chance to perform.

All of these examples portray challenges of decentralization that Corposol should have analyzed or anticipated prior to expansion, or at least addressed once problems began to arise. In each case, the institution declined to make the short-term investment needed to preempt difficulties and paid the price for its shortcuts in the medium- and long-term disillusionment of its staff and clients and, ultimately, in the quality of its portfolio. The rural program was subsequently dismantled and lending in those areas discontinued, in part as a function of the gravity of the delinquency problem.

Product Diversification. The leap from Corposol's interesting conceptual initiatives to bringing a series of new products to market was a large one. Unfortunately, the pace of that process precluded both adequate preparation of the organization to embark on such a phase and sufficient development of the initiatives. A more thorough approach to these two aspects of preparation might have made a difference in the ultimate success of the initiatives.

Corposol erroneously assumed that success at solidarity lending equated to success with other credit products, and that existing managerial expertise was transferable to the new initiatives. Yet, the challenges associated with each new business differed from those Corposol previously encountered. For example, inventory management issues, such as demand projection and internal stock control, and construction project planning were unprecedented in the experience of Corposol. The lack of corresponding expertise left technical gaps. Had management fully recognized how much there was to learn from the experiences of other institutions operating in the fields of the new initiatives, it might have been able to lower the learning curve and avoid costly mistakes.[109]

Corposol might have overcome these technical deficiencies in leadership had it contracted with consultants or hired professionals trained in scientific research and development to support the exploration of new initiatives. Yet, the organization did not have or seek individuals with the requisite skills. With the notable exception of Finansol, Corposol did not back its initiatives with analyses of a depth commensurate with the scale of investment made.[110]

Similar lack of analysis affected the success of other products as well. Problems occurred in the design of product characteristics relative to client needs, and in procedures related to product use, both of which had bearing on the quality of portfolio disbursed with those products.

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[109] Some observers noted that Corposol management was often overly self-assured, to the point of rejecting relevant technical advice solicited and proffered if it did not coincide with management's position. This attitude inhibited the potential strengthening of the management team.

[110] Prior to the establishment of Finansol, two independent feasibility studies were conducted (one for a bank, the other for a CFC), in response to a requirement of the superintendency.

- Construsol loan amounts were limited to a maximum of about $3,000, with terms significantly longer than those of other Corposol loans. This amount was not always sufficient relative to the scope of the projects planned, and the Construsol architects, pressured by performance objectives, were not always sufficiently realistic with client plans. The insufficient loan amount often led clients to seek an additional loan from another source in order to complete their projects, augmenting repayment risk. This risk was compounded by the fact that Construsol loans were less likely to represent a potential income-generating investment than were other Corposol loans.

- The program for individual loans forfeited the methodological tenets of solidarity group lending (such as graduated amounts and terms) without establishing a system for achieving the same security.[111] Nor were these loans supported with policies and procedures for credit and risk analyses that reflected the characteristics of individual borrowers (such as their likely eligibility for credit from other sources in their markets).[112]

In sum, Corposol management sometimes acted imprudently in the rush to market new ideas. This tendency was exacerbated by the lack of technical leadership that possessed the necessary criteria to pursue development processes with sufficient depth and support. Subsequent problems encountered with the new initiatives might have been avoided or minimized had Corposol dedicated additional professional resources to comprehensive market and feasibility analyses as well as assessments and development of methodological adaptations. Employing carefully monitored pilot programs prior to launching new products would also have limited Corposol's experimentation and adjustments.

Corposol's Development of Mercasol

Branch staff were the primary locus for information as Corposol began to develop the Mercasol concept. Loan officers were asked how they thought their clients would respond to the idea; they were asked to conduct focus groups in order to assess demand, and they were asked to fill out surveys. Yet, these efforts were not structured to produce realistically the quality of data required to substantiate the decision to make an up-front investment the size of that required to establish Mercasol. Such mechanisms depended upon already overburdened loan officers to perform additional functions. Moreover, the sort of qualitative validation the loan officers performed did not really quantify how many potential Mercasol customers existed in the market, nor did it assess how much lower prices would have to be for clients to travel to Mercasol outlets for their supplies. A team dedicated to such a study, with experience in market data collection, might easily have generated more comprehensive and scientific information.

Beyond the insufficient market assessment, Corposol also failed to conduct a comprehensive evaluation of Mercasol's operational and financial feasibility. An analysis of what volume Mercasol would need to do to cover its operational costs, given the minimal margins it could achieve, might have changed the decision to launch. A former analyst from Corposol's Projects Department said a formal feasibility analysis was never performed. To satisfy his personal curiosity, this professional performed such an analysis for one of the proposed Mercasol branches on his own time. When he shared the discouraging results of his study with management in hopes of modifying its plans for immediate expansion, he was ignored. Months later, the operational results of that outlet proved him correct: the store never generated sufficient volume to recuperate even its original investment, much less cover its operating costs. The outlet was subsequently closed.

[111] Traditionally, initial small amounts and short terms are extended over time based on a client's credit history, as a means of gauging clients' needs while mediating risk in the absence of a detailed credit analysis.
[112] Cited in a field assessment performed in April and May of 1996 by commercial operations specialists from ACCION International.

The same tide of enthusiasm that led management to gloss over the necessary levels of analysis and development of new products also caused management to bypass many essential steps in preparing the organization to work with the new products. The new product training and information Corposol provided illustrate this attitude.

Loan officers played a critical role in new product launches, explaining the products to clients, determining whose needs the products met, and selling the products to the appropriate clients at levels in their best interest. In order to do this consistently, loan officers and branch managers should have been trained in all new products and how to work with them. Unfortunately, the strategy Corposol management applied to accomplish this training was insufficient and overly dispersed. Branch managers received a brief introduction to the products and were told to disseminate this information to their staffs. In the absence of a comprehensive set of policies, procedures, and norms, however, each manager was left to prepare his or her staff in his or her own way. In response to unanswered questions, this led to improvisation by managers relaying the concepts and by loan officers applying them.

Support. Growth also had serious implications for essential support functions. In many instances, Corposol management failed to monitor and adjust the equilibrium between growth and institutional capacity. Though volume was driven in field operations by performance objectives and accelerated hiring, the acquisition of additional back-office support to process that volume was not governed by similar principles. Whether a question of priorities or oversight, the resulting indirect costs of quality and efficiency loss were significant for Corposol.

Loan Processing. From late 1993, with the creation of Finansol, prior to Corposol's most notable growth spurt, the volume of loans to be processed exceeded existing capacity. Back-office credit operations strained to keep pace with the volume of lending generated by the aggressive performance objectives. Staff preparing disbursements found it necessary to work at an unsustainable pace and on overtime to keep up. This, understandably, increased the incidence of human error, with important operational implications. In some cases, disbursements were delayed by as many as three days, thus compromising client service and satisfaction.[113]

At the same time, despite the fact that volume driven by management-determined goals should have been somewhat predictable, treasury staff describe a "lack of planning" on the part of their superiors. In the area of liquidity planning, management would often communicate some need for funds "at the last minute," sometimes to meet lending demand and later to meet payments on obligations. This resulted in a scramble on the part of the treasurer and led to a higher cost of funds.

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[113] This is a methodological problem, as agility is one of the essential elements of meeting client needs in a sector characterized by short business cycles and windows of investment opportunity.

Information Systems. Volume became a problem in information management early in Corposol's life. For example, prior to the creation of Finansol, whenever clients preferred to pay in the central office rather than at the Banco de Bogotá, the systems for receipt of payment became a problematic bottleneck. The cashiers had three slow computer; thus, when volumes were heavy, others helped out in receiving payments manually, with receipts that later had to be added to accounts by hand. This delayed processing and led to extremely long hours and other problems. Anyone available would help out when there was a bottleneck. Not all were trained as cashiers, however, and thus they were prone to errors such as receiving false bills, which represented a loss to Corposol. Worse, one employee suggested that the administrative confusion that ensued created opportunities for irregularities (or "fishing," as he put it) on the part of employees. Systems staff indicate that more effective technology was available on the market that could have helped resolve such bottlenecks, yet "there was never time" even to explore the alternatives.

Effects of New Products on Client Repayment Capacity

Although Corposol's introduction to new products may have been conceptually clear, the technical skills required to deal with new lending parameters (such as parallel loans to the same client) were insufficiently addressed. For example, in the absence of a procedure for determining what level of automatic Mercasol credit would be appropriate for a given client, many loan officers applied the same payment capacity they calculated for traditional working capital loans, without always taking into account the client's other outstanding debt. Such a strategy, applied to multiple credit lines, often led to client overindebtedness, which was exacerbated by loan officers' inconsistent preparation in credit analysis.

Knowing that gaps existed in loan officer preparation for work with multiple credit products even with regard to such a fundamental concept as client payment capacity, one can only imagine how the lack of training affected other aspects of the client service the officers provided. Such a deficiency represents a time bomb for a lending operation in which client satisfaction and repayment are paramount, as desertion and delinquency can be fatal.

In 1993, systems staff began the process of converting from Corposol's existing system (known as "PIC") to a UNIX-based system. Although begun during a season with minimal lending, the process presented its challenges. For one, it created a three-to-four-month period during which disbursements were made via UNIX while recuperation was handled via PIC until a glitch in the new system could be resolved. This entailed a laborious process of manual accounting for loan liquidation. Although some data from 1992 were distorted in the transition of databases to the new system, the system was ready prior to the establishment of Finansol. However, each new credit line or requirement of the superintendency required adjustments and systems staff, and the institution's technology was unable to keep pace with Corposol's leaps and bounds.

When Finansol's president presented a detailed diagnostic of the institution's weaknesses in March 1996, deficiencies in information systems were among his key concerns. At that time, he characterized the "modular" system as being held together with patches, because of its numerous adjustments. Moreover, aside from their individual weaknesses, the portfolio and the accounting and budget systems were not integrated and produced inconsistent information. Despite a daily closing of accounts, at that time it still took Finansol four to

seven days to produce a portfolio report for branches because of delays in repayment information (from banks and branches), manual adjustments to information, and other inefficient processes. This meant that loan officers received information about client repayment (or lack thereof) only about once a week, and even then the information was incomplete, making it difficult for loan officers to maintain close controls on new lending or recuperation.

Subsequently, a more in-depth analysis of Finansol's information system generated recommendations for adjustments. Although the process is still ongoing, many recommendations have been carried out, and staff have noticed significant improvement.

Human Resources. Despite the importance of human resources to Corposol's provision of services, management did not make it a high priority relative to other, "productive" efforts. As such, Corposol's Human Resources Department was insufficiently staffed and supported by management, as further described below.

- Despite the fact that hiring of loan officers became a high priority in late 1994, when management wished to accelerate lending growth, the Human Resources Department remained minimally staffed. The initial performance objective set for 1995 in the area of personnel was 360 loan officers. Meeting this goal would have entailed hiring 114 new loan officers, implying the processing of an applicant pool multiple times that size.[114] Approval was given to hire two additional human resources professionals, but by mid-1995, when the institution experienced a cash-flow crisis, three of four department members were let go. From that point forward, the department head attempted to fill gaps with low-cost interns (who had no experience and required supervision), which compromised the quality of hiring. Staff recall "inhuman" efforts, stress, and necessary shortcuts, such as reducing interviews from 45 minutes to a bare minimum of 10 to 15 minutes. Corposol finished the year with only 202 loan officers, a net loss because of employee turnover.

- Corposol's expanding scope generated challenges for personnel management, including employee stress and morale management and training to keep pace with new responsibilities. The Human Resources Department developed courses, workshops, and other means to address each of these issues, but they were generally undersupported by top management and, therefore, underutilized by staff.

- Beyond hiring and training, the organization of Corposol's human resources was not optimal. The organization's structure was informal and undocumented prior to its rapid growth, then evolved in an organic manner that at times created ambiguities with respect to the functions, responsibilities, and authority associated with each position. This generated a corresponding ambiguity in titles, salaries, and the hierarchy itself.[115] Such ambiguities complicated communication, responsibility, and authority for decision

[114] At that time, the department was processing an average of 150 to 200 candidates per month in order to hire an average of 70 employees to meet the collective needs of the holding company.

[115] For example, despite the financial straits of the organization, the president still earned close to 30 times the amount loan officers earned in 1996.

making. Although Corposol began to address these deficiencies in 1994 and 1995 in creating the Organization & Methods Department, and by hiring a team of consultants to begin documenting functions as an input for formalization and realignment, few results of this process were implemented prior to the dissolution of Corposol.

These examples reflect an unfortunate paradox: One of the pillars most essential to supporting Corposol's growth was its human resources. Although potential capacity existed within the organization to fortify that pillar, it was never fully utilized, leaving the institution inadequately supported and less stable under pressure.

Client Training. Support for client training was worse compared with support for credit operations. Although it is understandable that lending was a priority, credit clients were required to pay for training services with their loans. Thus, in theory, Corposol's ability to provide those services should have accommodated its pace of client growth. Unfortunately, that was not the case.

- In one municipal branch, no client trainer was provided, yet clients were still charged a training fee. The municipality was too far from the city for clients to travel elsewhere for courses, so the staff of that branch had no choice but to improvise training or accept client complaints of injustice.

- Despite the apparent investment in training infrastructure, urban training staff explain that had all 40,000 clients and their families actually used the training services to which they were entitled, the existing infrastructure would never have been sufficient to meet demand. The fact that class participation was often low gives some indication of client utilization of this service.

- Client demand for training was likely an indicator of the degree to which course offerings met their interests. Based on a summary of available courses provided by the Corposol

Support for Agrosol Client Training

- A former Agrosol trainer explained that the program's trainers were subject to what he considered infeasible performance objectives. At one juncture, he remembers there were 12 loan officers in his zone and two trainers. At an average of 15 *colectivos* per loan officer, the trainers were hard pressed to structure even one workshop per month per *colectivo*. Given the logistics of traveling between widespread rural areas, on average they could visit a maximum of 4 sites per day, yet the official goal was 10, because of a commitment to a donor. When staff requested the hiring of additional trainers to help meet the goal, their request was denied on the grounds of "lack of funding" available.
- Despite the often highly specific technical assistance needs of Agrosol clients, a former loan officer explained that the officers had to make do however they could once the volume was too great. When they had a manageable group of clients, the loan officers could pool their expertise to find the right solutions for clients' needs. Once things were tight, a veterinarian might be sent to help deal with a potato plague, causing clients to lose faith in Corposol's potential technical value-added services.
- When additional resources were made available to improve a program, they weren't always effectively invested for that program. For example, a donation made to improve Agrosol's training materials might be used to pay central-office staff (who lacked the appropriate expertise) to produce the materials, rather than to tap fully the knowledge of potentially helpful field personnel.

> Didactic Materials Design Department at the height of operations in 1995, technical training courses for urban borrowers (which represented 84 percent of the course hours available) were focused in only three major categories, which included a total of 11 economic activities, representing a small fraction of the activities in which Corposol clients were engaged. In addition, many of these had only a token course or two, thus offering clients in those fields few options for acquiring the training associated with ongoing credits. Beyond basic business management courses, a majority of Corposol clients had no further direct options. These course offerings could explain why a significant portion of the participants trained were not clients but employees or family members gaining some auxiliary skill. This may have supported the organization's goal of benefiting the community at large, but no study was done to evaluate whether, given the option to do something else with their money, clients would have chosen to pay for the training offered.

It appears the personnel development necessary to ensure that the quality of training services would keep pace with Corposol's client and portfolio growth was not sufficient to ensure a consistent level of cost-benefit to the client. This effective decline in client service had a direct impact on lending operations. Loan officers concur that "clients noticed" both the costs of the training services and what they received for their money's worth. According to field staff, the more corners the organization cut, the more clients began to perceive the institution's problems. Once this uncertainty was in the marketplace, it became an additional negative influence on client repayment.

Legal Recourse. Once loan recuperation problems began, legal support for the judicial process was inadequate. One lawyer was contracted in the last quarter of 1995, but his efforts were insufficient to deal with the serious cases of arrears sent by 20 branches. A professional who was later given responsibility for a special loan recuperation task force cited clients who had been delinquent for years who were not aware their cases were in a judicial process—they had never been contacted by the lawyer.[116] In some zones, prosecution was sporadic, confusing clients and further complicating future recuperation. Had Corposol sought more effective support earlier, a different message might have been communicated to the market, and the losses associated with the writing off of bad loans might have been reduced.

INSTITUTIONAL CULTURE

An institution's development is grounded in its core values, as defined by its founders, directors, and management and as applied by its personnel at all levels. This aspect of organizational development, albeit less tangible than others, is critical in that it encompasses and shapes the dynamics of the other elements previously discussed. More specifically, institutional culture drives the reason staff perform their duties, how they feel about their work and the organization, the values underlying operating parameters (thus affecting operational efficacy), the quality of work, and hence both internal and external success.

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[116] The *Fuerza Especial de Cobro (FEC)*, created in 1996 by the president of Finansol to focus on the recuperation of problematic loans, has had encouraging results, despite the scale of its challenge.

This section discusses the evolution of Corposol's institutional culture, which accompanied and in part drove the rise and fall of the organization. The section looks in particular at changes in the organization's approach to its mission over time, the role of leadership throughout, and the impact of cultural change within and beyond the organization.

Mission and Vision: From Dream to Myth

The original statutes of Actuar Bogotá describe the institution's mission as follows:

> La Corporación tiene por objetivo el desarrollo integral de la persona humana. Busca inicialement solucionar a los desposeídos su incapacidad de subsistencia mediante la obtención de ingresos, derivados del autoempleo dentro de la empresa familiar programa este que impulsará económicamente la Corporación a través de otorgamiento de créditos a los famiempresarios.
>
> En la medida en que prospere la solución del problema económico, esta entidad deberá promover la creación de programas de capacitación, recreación, salud y en general, de toda actividad que coayude al desarrollo del hombre, para conseguir así que esta población marginal se vincule activamente a la comunidad organizada.
>
> Con el mejoramiento de la situación económica de la población marginada se busca disminuir hasta llegar a la extinción en nuestro Distrito del flajelo de la inseguridad, para poder disfrutar de una sociedad en la cual la moral, el bienestar social, el trabajo y por ende su desarrollo económico vuelvan a ser los pilares de su existencia.

In short, this expresses Corposol's fundamental objective of integral human development, defined to encompass two goals: (1) the immediate goal of addressing the needs of the destitute by providing economic opportunities to microentrepreneurs, and (2) upon resolving the most critical economic needs of the sector, the broader goal of diversifying services to include training, recreation, health, and others that would improve the quality of life among the poor and marginalized and help incorporate them into more formal society. The mission expresses the hope that meeting these goals would reduce and eventually eliminate insecurity, permitting a society whose pillars of ethics, social well-being, work, and economic development are restored.

These concrete goals were accompanied by the vision, charisma, and enthusiasm of Corposol's founder and president. Together they created an operational philosophy in the organization that inspired employees and third parties alike. Current and former staff who recall the early years describe aspects of that philosophy fondly. The client was the central focus, they remember, and the staff-client relationship was to be one of mutual trust, respect, and friendship. Similarly, the role of the loan officer was to find the best way possible to meet clients' needs via loans, technical assistance, and training. The counterpart of this

understanding was that the client valued the opportunity Actuar/Corposol offered and respected the commitments implied in the client-vendor relationship.

This commitment to the good of the client took many forms. One former branch manager explained an important value that guided early operations. She inculcated her staff with the importance of their responsibility to make good lending decisions and what that entailed, essentially helping them understand that more money, in and of itself, was not always a good thing for clients. In other words, loans that exceeded a client's ability to pay or to invest productively could ultimately decapitalize the client's business, and thus were not in the best interest of the client or the institution.

Another tangible application of Corposol's mission during its first years was the provision of technical advisory support. Loan officers interviewed describe this as one of the most fulfilling aspects of their jobs and one of the most appreciated by clients. It entailed a collaborative process of identifying and pursuing means of improving clients' businesses, which promoted both the development of a trusting rapport and a sense of the potential technical value loan officers could bring to clients' success. The provision of this service also added to the sense of teamwork among loan officers, who often worked together to help solve clients' problems. Loan officers even sought external support at times in order to provide the optimal answer for a client, demonstrating both the commitment they felt to help their clients and the quality of service provided.

At times, the pursuit of these goals required a tremendous effort on the part of field personnel, some of who explained to interviewers: "We worked at the pace of the microentrepreneur," which implied a "nonstop" pace according to the characteristics of many markets. Moreover, especially in the beginning, field staff were paid very little and often had very little budget or support with which to work; a "bootstrap" mentality existed that likely derived from the founder's own life experience. Yet, staff recall with pride and ownership having built Corposol from scratch with, at times, little other than their own initiative and hard work. Moreover, they describe Corposol as a close-knit "family" that even enjoyed leisure activities together.

Most important, the commitment staff felt to the "dream" of helping improve the quality of life for a whole sector of society, the fulfillment of making a difference, the camaraderie of working together against odds for this important cause, and the belief in the potential success of their efforts, fueled by their leader, created a positive tide that motivated staff and bolstered all efforts.

By late 1994, however, perceptions and application of the mission, as well as employee sentiment about the general vision of the organization, had changed dramatically for many.[117] In contrast to the previous concern to lend as a function of clients' needs and payment

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[117] Note that no specific watershed event occurred; rather, this was a gradual process. Employee perceptions of when the culture began to change vary. Some described noticing changes as early as 1991; others mentioned becoming aware of problems as late as 1995. These differences seem to be a function of proximity to top management and time with the organization, as each person's point of reference for comparison varied with his or her starting point and position.

capacity, the modus operandi had become one of lending as much as possible with little consideration for the prior parameters. At the same time, technical advisory services had been edged out by augmented lending. The combination of these two changes produced clients who were overindebted and dissatisfied with the elimination of a key service.[118]

Clearly, at this point the previous philosophy of service dedicated to the needs and best interest of the client no longer guided the institution. In fact, as staff watched management decision making over time and felt the pressure for growth at all costs, many came to question whether the institution still existed to serve the client or whether lending to the client had become a vehicle to serve the institution. This concern was compounded by the fact that employees felt their relationship with the institution had changed as well. Staff explain that the sense of "family" that once bound them together disappeared, and that they began to sense they were a "disposable" resource, exploited by management's demands and treatment.

The combination of these changes led to growing skepticism among staff toward their jobs and Corposol, as they began to question the impact of their efforts and management's true priorities relative to the stated mission. Loan officers who had been motivated by their commitment to the client recognized that they now were making loans driven by pressure and fear and felt both betrayed and guilty of betrayal. Loan officers hired in this era recall an initial enthusiasm for the "dream" they were "sold" upon being introduced to the organization, but describe a rapid process of disillusionment that occurred as the practices they saw in the field showed that the dream was in fact more of a myth.

As a result, staff commitment to the organization dwindled, and the operating environment became one of mistrust, fear, pressure, and resignation, in stark contrast to the determined, motivated camaraderie of earlier years. An experience in early 1995 was a clear indicator of the changing tides in the organization relative to the president. In a time of massive loan restructuring as portfolio quality problems reared their head, the president called all employees together with the intention of "injecting them with a dose of the spirit" he believed would motivate them to accomplish the impossible in cleaning up the portfolio. One middle manager referred to this as an act of "theater." Charisma was no longer enough to rally the staff, however; one employee described the auditorium as "a graveyard," showing that the president had lost his emotional hold over his staff.

This dramatic shift in the pursuit of Corposol's mission and its impact on the organization's culture can best be described as a function of the evolution of its leadership, the primary font of Corposol's original inspiration, as well as its ultimate demise.

[118] At the extreme were clients who began to leverage the fact that they were doing their loan officer "a favor" to accept a loan, in order to negotiate larger credits, which were not always prudent.

The Evolution of Corposol's Leadership and Operating Characteristics

Although Corposol was under the same leadership from the creation of Actuar Bogotá in 1988 through the dissolution of the Corposol holding company in 1996, that leadership took on many faces in the course of the organization's development. Each of these was manifested by changes in management behavior and decision making accompanied by changes in operating characteristics. Each also affected Corposol's institutional culture and in turn, as indicated above, affected Corposol's employees and clients. This section discusses the phases in the evolution of Corposol's leadership and their ramifications.

The Rising Star

In starting Actuar Bogotá, the organization's founder began a crusade to do what many considered impossible. With a minimal budget from a very small group of supporters, some experience in a methodology that had proven itself in other countries, and a field staff of three, he set out to prove what microentrepreneurs from Bogotá's poorest sectors could do if given the opportunity in the form of capital. Moreover, he intended to reach the masses in leaps and bounds, while building a sustainable institution.

This man's indefatigable energy, his contagious enthusiasm, and his impressive ability to convince people of his vision all inspired his supporters, staff, and clients. Current and former employees all explain how in the early years they had admired him and aspired to his intelligence and the success he achieved despite his humble origins. More than one referred to him as "un dios" (a god). This deification of their leader inspired the categorical support and alignment of the staff.

A Failed Venture

In 1991, management initiated a project for exporting clothing. Employees recall that the idea was explained as a means of helping clients begin to develop export channels. A staff member put in charge of this project for its four-month life explained, however, that once the deal was arranged, staff discovered that the clients considered for participation were unable to produce the quality or quantity necessary to fill orders. In response, Corposol contracted workshops, instead of clients, to do the work. Corposol staff and their families dedicated their weekends to helping prepare shipments, but they missed the deadline anyway, and the purchaser consequently refused to receive the goods. Unfortunately, this left Corposol with a substantial investment in clothing and no buyer. Staff recall many subsequent efforts to get rid of the clothes, even resorting to selling them from the Corposol branches.

Information is unavailable to quantify the total loss associated with the failure of this venture, but nonetheless the project serves as an important example of an initiative that Corposol might have chosen to pass up had a comprehensive analysis of its feasibility and projected costs and benefits been performed in advance. Moreover, as a venture that utilized Corposol personnel and facilities yet ultimately had no perceivable benefit for Corposol clients, the clothing project offers an early example of a management decision the motives for which may not have coincided with the institution's mission.

When staff who participated were asked what they thought at the time, a few explained that among themselves they had questioned the venture yet still felt it would be almost a sacrilege to doubt their leader; thus, they supported the project along with everyone else. Such was the executive director's hold over the organization. This demonstrates that the tendency toward unconditional superficial support for the mandates of Corposol's leader, despite staff's inner doubts, was another destructive element that took root early in the organization's development.

Corposol's exceptional results during this period have already been discussed in previous sections. The pace of the organization's client outreach and healthy operations caught the eyes of practitioners, donors, investors, and public officials, all of who saw in Corposol new hope for some of Bogotá's poorest sectors. Their interest translated into support and funding to fuel efforts further, and Corposol was hailed in the industry as a model with much potential.

The organization had so little hierarchy that the executive director was still integrally involved in operations, attending community meetings to open new zones, sharing the vision with clients and staff, developing field operations, and troubleshooting along the way. Staff felt he sought and valued their input on major decisions. Communication was open and participatory, though the executive director's final decision was always accepted unconditionally. Ambitious goals were set, achieved, and mutually celebrated. All operations were informal, though controlled by the proximity of management and the premise of trust and individual accountability.

The organizational culture in this period was characterized by hard, honest work and motivated commitment to clients, Corposol, and Corposol's cause.

Stars in His Eyes

With an appetite whetted by success, each time the executive director saw his staff was able to meet increasingly aggressive goals, he ratcheted up production standards and extended performance objectives still further. This increased the pressure on field staff and began to influence lending practices as early as 1991. Many cite this as one of the first roots of the decline in portfolio quality: as compliance with lending goals became a condition of employment, it began to eclipse the client as first priority, pitting growth against faithfulness to the mission.[119] Yet, recognition of Corposol's achievements by the press and other institutions kept employees' pride in their contributions strong.

Bolstered by the desire to continue exploring new ways to excel, management began to pursue new and different initiatives, conceived of as extensions of the mission. The ill-fated health center, mentioned in Chapter Three, was an early example. Some subsequent initiatives in hindsight showed similar signs of being overly ambitious, insufficiently analyzed, and costly management decisions, a pattern that became more severe as the stakes grew higher.

Along the same lines, given the universal desire that Corposol achieve its dream, employees were not overly concerned when management emphasized the importance of putting the organization's "best foot forward" in order to enhance the institution's image in the public eye. Yet, the innocent "adjustments" to growth and portfolio quality indicators in reports to donors and the public were the roots of another unhealthy value that began in this era and later grew into a more serious vice. This practice also helped insulate Corposol from critical

[119] This was compounded by the fact that in this period, the volume of new personnel relative to experienced staff was such that transmission of the mission, vision, and culture became somewhat diluted, because of the nature of training.

eyes that might have helped shape a different future. As it was, until years later, such careful "image management" blinded much of the industry to any perception other than that of Corposol's bright future.

Beyond the shift in values exhibited by management behavior during this period, staff describe changes in the operational dynamic that intensified in subsequent phases of Corposol's development. As operations grew and layers of hierarchy were established to maintain order, a distance began to develop between the executive director and his field staff. Between 1991 and 1992, when associates of the executive director were hired to play key deputy director roles, this gap was broadened. Ironically, while distancing the leader from the variables he needed to do a good job, the change began to centralize more operational control with him. Although periodic meetings with branch managers continued for some time under the deputy directors, they lacked both the technical experience to have credibility with the branch managers and the charisma to inspire them. Discontent grew among field staff as they realized that their input was no longer being taken into account in planning or decision making. From this point on, real communication shifted from being two-way to being primarily top-down, taking the thumb of the chief decision maker off the pulse of the organization.

At the same time, the operations managers (who had been with the organization since its inception) felt betrayed by the fact that they were not given the opportunity to compete for the deputy director positions. Over time, this sentiment proved to be a significant source of discord and "demotivation" among field staff. Worse, as staff saw the performance of these and other top managers, they perceived deficiencies in concrete qualifications for the positions, other than allegiance to the executive director. This tendency of the executive director to surround himself with "yes men" rather than with the most qualified professionals reinforced his centralization of control and deprived him of critical technical support, both of which proved fatal.

By 1993, another weakening factor emerged. Field staff, like most offspring, following their leaders' example, wanted to excel relative to the values set, regardless of cost. This generated a sort of internal competition and individualism that eroded the previous unity. One loan officer gave a different perspective, explaining that the organization itself paled in the glow of its "brilliant" leader (for it is important to remember that throughout this period, despite the first blush of internal problems, Corposol was still hailed as a leader in the industry). This personal sentiment later proved a downfall. When disillusionment destroyed their commitment to the president, staff had little left to bind them together.

Star-Crossed

The first significant external jolt to Corposol's culture occurred with the launch of Finansol. Previous chapters discuss many aspects of the operational ramifications of the differences between Corposol's NGO mentality and that required for effective management of a regulated financial institution. A clear understanding of the true impact of this obvious culture clash requires disaggregation of its symptoms.

The most commonly cited "problems" with the first administration of Finansol are superficial. They include Corposol staff's perception that Finansol bankers "didn't understand" the idiosyncrasies of Corposol's clients or its methodology, that they were too "formal" and "bureaucratic," and that they expected a budget and salaries "out of line" with those appropriate for the organization. Most who made those criticisms, however, did not question whether sufficient attempts had been made to help Finansol's first management team understand the nature of microfinance, whether some of the formality might have been necessary, or why Corposol had inequities built into its salary scale long before the establishment of Finansol.

Although the aforementioned differences are the most commonly cited, they were not the most critical differences; in fact, they may even have been resolvable. Rather, the fundamental attitudes about informality that had driven Corposol's operations throughout its history constituted the critical element that came into conflict with the minimal standards required for managing a regulated financial institution such as Finansol. For example, by the time Finansol was established, the "growth at all costs" mentality and consequent methodological shortcuts and breaches were firmly entrenched in the lending operation, as was the practice of sweeping bad loans under the rug.

For Corposol, the price of these bad habits had been inconsequential up to this point. Once Finansol was required to make provisions for the risk in its portfolio, however, the burden was overwhelming for a new financial institution struggling to break even. Although accounting practices changed as a matter of course, it was not so easy to encourage 174 loan officers bred on informality and pressured by performance objectives to do a U-turn in their lending procedures. The operating culture, personnel development, and control structures all proved barriers. Worse, the unwritten but understood-to-be-permissible code of "flexibility" had permeated clients' repayment culture as well. Clients accustomed to late payments being "overlooked" as long as they paid eventually were confused by the apparent policy change when they began incurring penalties and interest on payments in arrears. For some, this created a resistance to payment at all, thus augmenting Finansol's portfolio quality problem.

Further examples of the clash between the NGO mindset of Corposol's president and the standards required to manage a regulated financial institution run through to the end of Corposol's trajectory. One observer commented that the man at the helm still behaved as though he were playing with Monopoly money, even once the stakes were real.

This clash with formality was not the only Achilles' heel in Corposol's organizational culture. By late 1993, there were a number of warning signals:

- In October 1993, when operational managers met with branches and discussed proposed changes such as the creation of the holding company and related new businesses, field staff were "paralyzed with fear," out of concern for what that would mean for their performance objectives and, more important, whether such changes were in the best interest of clients. This suggests that even three years before the institution eventually collapsed, staff at the level of loan officer had begun to doubt their leader's judgment.

The operational managers remember then thinking that Corposol was a “house of cards,” yet top management was deaf to their concerns.

- As mentioned, despite increases in salary and benefits at the end of 1993, in April 1994, a review of Corposol’s “motivational climate” showed cause for concern. Primary reasons employees cited for their malaise included the following.[120]

  — Confusion and uncertainty because of the lack of effective communication about issues ranging from credit policy changes to the structure of the holding company;

  — Lack of adequate support for both operational logistics (for example, receipt of timely portfolio information) and training; and

  — The autocratic and hot-tempered nature of their executive director, which precluded staff’s participation in operational or strategic planning and decisions.

Unfortunately, even such direct messages did not elicit a strong enough response from management to curtail staff morale problems. At the suggestion of the consultant who had done the 1994 assessment, management made a brief attempt to conduct “therapy” sessions with staff. The plan was discontinued after two sessions, however, because of “lack of time” for such activities.

As described in earlier chapters, a token Human Resources Department was created, but its initiatives never had sufficient management support. For example, in response to the study results, the new department developed a workshop to help staff with stress management. Yet, the workshop was never implemented, for the same reasons the therapy sessions were discontinued.[121]

Management made few other direct attempts to address the deteriorating status of personnel satisfaction. On the contrary, management continued to operate in ways that made matters worse. Examples included raising the stakes on performance objectives, then not coming through with the promised rewards, and taking away activities designed to improve staff morale as punishment for lack of aggregate compliance with goals.[122] Each of these contributed further to employees’ loss of faith in management and discontent with their jobs. The apparent contradiction between the organization’s humanitarian mission and management’s demonstrated lack of commitment to employee well-being created a disturbing dissonance among staff.

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[120] This assessment was performed by the Fundación Neohumanista, Santa Fé de Bogotá.

[121] The failure to perceive the importance of human resource management was not limited to the president of Corposol; other top managers seemed to take his cue. For example, when the Human Resources Department developed a “reorientation” course designed to help new employees better understand Corposol’s mission and vision, attendance was slim, suggesting that managers were not firm in enforcing participation.

[122] The former occurred in the Agrosol program with respect to 1995 goals: by the time they were met, Corposol no longer had the cash flow to make good on its promises to employees. The latter refers to the companywide Corposol Olympics, scheduled for 1995, which were canceled at the last minute because of employees’ failure to meet overall growth expectations.

One factor that contributed to the employee morale problem and others was the continuation of one of the trends whose roots were discussed above. The executive director's form of relating to and relying upon his staff had continued to evolve, and by late 1994, his previously inclusive style had shifted to one of completely centralized control and micromanagement.[123] Those who were middle managers at the time say he no longer trusted them. They also explain that attempts at operational input in planning and the concerns they voiced about the organization's direction fell on deaf ears.

The organizational assessment performed by Talento y Estratégia in 1995 highlighted many dysfunctional characteristics of the organization at that time. For example, the consultants concluded that true autonomy existed only at the level of the president, whose micromanagement created an ambiguity among operational staff with respect to decision making and communication. Worse, this ambiguity precluded independent thinking on the part of the leaders of subsidiary components of the holding company, some of whose operations might have benefited from their asserting their interests more strongly. The consultants commented that it was clear from the way the president responded to their objective observations (usually rejecting their perceptions with anger or discrediting ridicule) that he was not accustomed to being contradicted, as he had surrounded himself with a management team that served primarily as an "echo of his own ideas." One of the consultants observed that such was the president's power complex that he even created symbolic reinforcements, such as the construction of a private staircase to his office.

The president employed several mechanisms to create and maintain his autocratic power structure:

- He filled the key top management positions around him (including the heads of the holding company components) with friends, whose personal loyalties to him were sure to prevent any challenge to his authority.[124]

- In addition to the president's "inner circle" at top levels, was a handful of others at lower levels in operational positions key for manipulation of portfolio statistics, accounting practices, and so on. Some of these individuals were hired for their "built-in" loyalties (family or friends), while others were gradually co-opted over time. Psychologists within the organization who knew the people involved identified certain common denominators that might have caused these employees to give way to such manipulation. Namely, they seemed susceptible to psychological pressure because of their desire for social recognition or power that might have exceeded what they could have achieved on their

[123] This took absurd forms, including the president's waiting in a strategic place to document who arrived at work late, or sending individualized messages to staff beepers to apply pressure with respect to performance objectives. Employees refer to such practices as unnecessary "harassment" that accomplished nothing other than further intensifying stress in the workplace. Furthermore, the president's distancing from field operations was such that by this time he no longer had the same credibility with staff, augmenting their resistance to such forms of intervention.

[124] Though these executives were brought in early in the organization's development, even later, once Corposol had an official selection function in the Human Resources Department, the head of that area recalls the president at times handing in completed contracts to hire individuals who had not gone through a formal selection process.

own merits. As a result, some sought the "boss's approval," a source of self-esteem, with their loyalty. Others were held in their loyalties because of some form of leverage, such as economic dependence created by compensating key people beyond their worth in the market and encouraging them to live beyond their means via indebtedness.

- Experienced middle managers from the field who had knowledge of the organization and operations that could have helped keep the organization on track were marginalized. Those who deigned to cross the president, even with constructive criticism, were either ignored, immobilized within the organization to the point at which they gave up or quit out of frustration, or fired.[125]

- The same was true of the president's management of potential external sources of constructive criticism or technical support. More than one external specialist said that disagreeing with the president or identifying weaknesses in the organization was unwelcome.

- Throughout the organization, the president exercised a form of psychological manipulation. He used a heavy balance of scare tactics to drive employee response.[126] Staff who were close to him claimed they could differentiate between real rage and rage that he feigned in order to show or feel his power. Some suggested that no one was exempt from fearing him, citing as an example the president of Finansol, who was a good friend and at a level of hierarchy one would suppose would not be susceptible to subordination by fear.[127] A number of mechanisms were used to create such an environment. One of the most commonly cited was the threat of dismissal. One employee quipped, "He fired me various times," and all interviewed cited numerous cases. Other forms of psychological manipulation included blaming any "insurgency" or challenge to management's autocracy on the perpetrator (for example, accusing staff of "lack of

Mixed Messages

One back-office middle manager in Finansol recalls the credit approval process in the first years after Finansol's creation. The person in charge of evaluating loan requests was responsible for the quality of the portfolio and, as such, should have had the authority to reject applications that failed to meet certain minimal standards. (The absence of such authority would have made it impossible for him to do his job well.) Yet, there were times when he attempted to enforce lending standards by rejecting unqualified or inadequately prepared applications and was harshly reprimanded by Corposol's president. This sent a message to staff to obey the mandate of their leader at all costs, whether or not they believed it was the right thing to do. Many found this not only disempowering but also disillusioning and demotivating. It also created a value system in which rules and standards were negligible, a condition Corposol's experience shows can become a slippery slope.

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[125] One example of action to minimize dissension was the president's response to one employee's attempt to form a union. The president managed communication channels to the point at which he became aware of the plan, and he nipped the initiative in the bud by dismissing the employee and punishing others involved. This created a general paranoia about communication in the organization and led employees to keep their mouths closed because of a generalized lack of trust in the workplace.

[126] Some staff said he got pleasure from creating an operational climate of "terror." Whether this was in fact the case, the perception is an important sign of the way such strategies affected employees' view of management.

[127] In reference to the individual in power from April 1994 through August 1995.

commitment to the cause" if they refused to collaborate, or accusing anyone who pointed out a problem of being somehow responsible).

The president's application of his autonomous control had strong negative effects on the functioning of the organization's personnel structure and operations.

- He was known to cancel meetings he was unable to attend or decided not to prioritize, even when the committees involved should have been able to conduct their business without him. This created a sort of paralysis/dependency that inhibited the performance and true leadership of the professionals who theoretically held positions of power in Corposol.

- Some professionals were given only part of the authority they needed to do their jobs effectively, because of centralized control of information. For example, the professional responsible for the Client Training Department explained that he was asked to submit budgets that reflected his proposed costs, yet he was never privy to the amount of funding available for the area; thus, he could never make the most of opportunities provided by specific projects that should have supported activities in his area.

- There are many examples of the president overriding the authority of middle managers. Such managers describe the frustration of being given a responsibility only to have a degree of intervention from their leader that precluded their effective fulfillment of that responsibility. Sometimes such interventions directly undermined healthy operational practices and set a precedent that led to a gradual erosion of key standards.

- Hiring external consultants to help address problems in the organization, only to override their conclusions, led staff to give up hope of any substantive change in the organization. Such was the case with the salary curve analysis previously mentioned. Upon presentation of results and recommendations that were the product of a whole committee of the president's management team, he made autonomous adjustments, defeating the purpose of the study and the labors of his staff.

- Top management's centralization of authority over certain functions both distorted the functioning of related areas and disempowered middle management. In the case of the employee incentive systems that would normally be affiliated with the Human Resources Department, for example, definition of parameters and objectives, rewards or punishment, and enforcement were all handled by the president and executive director of Corposol, without the participation of the professionals who should have had authority over those subjects.

- Staff explain that the president's style had a ripple effect in the organization. Whether as a coping mechanism or as a learned leadership style, the autocratic enforcement of an "I'm in charge here" mentality created a hierarchical chain of command throughout the organization that augmented the reign of terror and further disempowered staff initiative.

Beyond the effects it had on the functioning of the organization, the unchecked power of Corposol's president led to poor management decisions and abuses of power with lasting consequences.

In sum, the president's positive vision and momentum led Corposol to achieve what it did in its early years. The positive motivational climate and client-service-oriented values were a winning combination within and beyond Corposol. The gradual snowballing of underlying ambition, however, clouded the president's vision. The subsequent erosion of Corposol's core values and corresponding operational culture showed how much influence leadership can have throughout an organization. More important, this experience illustrates how severely an operating culture that perpetuates fear-based motivation, negative reinforcement, stress, and insecurity can compromise employee behavior and results.

CHAPTER FIVE: IMPLICATIONS OF INSUFFICIENT ORGANIZATION

FIELD OPERATION STANDARDS

Oversight

Corposol's decentralized lending process, perpetuated via informal training mechanisms in the absence of unified, written operating parameters, could have benefited greatly from effective oversight. As was the case with other variables that were effective though informal while the organization was small, centralized control by program initiators lost its effectiveness as staff increased and became decentralized.

At the end of 1990, Corposol employed three coordinators to oversee approximately 30 loan officers, a number that doubled in 1991. The three coordinators had to supervise these additional loan officers, making each coordinator responsible for managing 18 to 20 loan officers. This arrangement created one of the first strains on the structure of lending operations, as it became impossible for the coordinators to play the same role in supervising, training, and maintaining quality control as had been possible with smaller staffs. As a result, branch managers were relied on to fulfill those functions. Thereafter, absent written governing parameters, strictness, or the lack thereof, in applying lending standards became a function of each branch manager's "style."

Current and former branch and regional managers interviewed offered various responses when asked about mechanisms used to supervise their personnel. Techniques employed ranged from very minimal direct measures to extensive accompaniment in fieldwork, periodic revision of client files, and hands-on participation in credit committees. This variation in supervision did little to curb the amplitude of the other informally managed variables cited above.

Unfortunately, other potential oversight mechanisms were insufficient as well.

- The internal audit function did not achieve sufficient scope. Although from 1992 to 1993 the department increased from one to four people (including administrative positions), field staff recall only a "very occasional" operational audit, with minimal revision of loan documentation relative to the volume being produced. The external auditors' revision of lending practices and documentation was similarly limited.

- Policies governing enforcement of basic procedures to help insulate the institution against certain risks, such as checking with other institutions on the credit status of potential clients, were insufficient.

- The Information Systems Department did not provide an adequate substitute for appropriate audit and risk-containment procedures.

This combination of factors permitted inconsistent lending practices to mushroom in Corposol before they were recognized or quantified. Examples of resulting aberrations are discussed in the following section.

Methodology Application

A combination of the factors described above contributed to the degeneration of Corposol's lending methodology. An overwhelming number of new loan officers, which precluded consistent training and oversight via existing informal methods, in a context governed by aggressive performance objectives with severe penalties for noncompliance, prepared the soil for the first seeds of bad lending that quickly took root.

At various points beginning in late 1995, after the resignation of the second president of Finansol and during the process of crisis resolution and rebuilding, field diagnoses were conducted to assess the health of lending operations.[128] A combination of loan documentation review and loan officer interviews yielded a significant list of "adjustments" to the original lending methodology:

- Ad hoc "streamlining" of the credit process as a timesaving "survival mechanism" for meeting quantitative lending goals. This approach entailed shortcuts such as forgoing certain standard procedures (including follow-up visits, verification of a client's other outstanding debt, and formation of healthy groups) or even sacrificing economic evaluation tools because of a lack of time.[129]

- Reduction of the required number of group members from four or five to three. This made it easier for clients to form groups and made it possible for loan officers to present a higher number of new groups with the same number of clients. However, having fewer members meant that a group would have fewer sources of support to fall back on in case of repayment difficulties, thus potentially weakening the solidarity guarantee.

[128] These diagnoses evaluated lending practices in both the urban and rural programs. They were requested by Finansol management and executed by ACCION International field staff.

[129] Failing to inculcate groups with the principles of solidarity, or, in the case of *colectivos*, neglecting to develop "statutes" to govern their internal functioning, can dramatically weaken the potential guarantee mechanism.

- The inclusion of clients who had been "recommended" by some staff member, whether or not they met the other requirements for a loan. Although this was seen as an easy source of new clients, such borrowers tended to have a different profile than those normally served, representing a potential conflict of interest. Not surprisingly, many of these loans were never repaid.[130]

- The formation of groups that included members who did not maintain independent economic activities (or, therefore, outlets for investment and sources of repayment) in an attempt to form the number of groups established by the performance objectives. Such a practice tends to augment repayment risk by adding members who depend on the same income source, which affords little security in the sense that any difficulty they might encounter with their businesses would inhibit their collective ability to respond, thus weakening possible recourse to the solidarity guarantee.

- The extension of loan terms (as much as 24 months for a first loan) made it possible to give the same clients larger loan amounts. Moreover, by reducing the average frequency of loan renewal, longer terms made it possible for loan officers to manage more clients at once, though with a more distant relationship. Unless terms bear some logical relationship to the nature of the investment to be made, however, this practice can represent a long-term repayment risk.

- For loans requiring guarantees, staff accepted inadequate cosigners, such as people with their own outstanding Finansol loans or individuals without independent sources of income.

- On the other end of the spectrum, in an attempt to improve the possibilities for loan recuperation, some credit committees began to require that at least two members of each solidarity group present some form of fixed collateral (such as land) as a guarantee. Although understandable as an attempt at greater security in lending, such a policy has two negative implications. First, lending against a guarantee may be considered "easier" by loan officers who believe it obviates the need for credit analysis. This can be risky because if the client has insufficient capacity to repay the loan, even attempts at recourse to the guarantee may make it difficult to recuperate the value. Second, requiring collateral may well run the risk of making loans inaccessible to many clients for whom the solidarity guarantee was designed (those unable to provide collateral guarantees), causing a sort of "market creep."

- Widespread refinancing, as discussed in Chapter Four, represents a key methodological breach initiated at the management level in mid-1995.

The same diagnostic processes noted evidence of the weakening effect that slack lending practices had on client groups. The lack of a cohesive sense of solidarity (an essential gauge

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[130] This represents one example of how field officers' improvisation for "survival" reasons began to have a questionable ethical tinge. Unfortunately, such gray areas were indirectly reinforced because they were not curtailed and were not unlike practices on the part of some at higher levels. Such loans often went to friends and family members of Corposol staff, alleged to include the president himself.

of the strength of the group guarantee if members encounter repayment difficulties) was widespread. Taken to the extreme, one rural assessment detected cases of fraud within groups (in one case, the group-elected treasurer was embezzling from collective savings) because of the lack of internal governance, a condition that further erodes the concept of solidarity and trust within groups and, therefore, the strength of the solidarity guarantee.

Fraud

Chapter Four describes the structural weaknesses that permitted mismanagement at the holding-company level. Some of the same variables (including flexibility and the lack of checks and balances) made Corposol's field operation equally vulnerable.

Inevitably, in a decentralized operation that relies on good faith in employees and monitors primarily quantitative results, opportunities exist for "lapses" along the way. As early as 1992, one former branch manager recalls having to fire loan officers because they had made loans to groups that did not exist. At that time, such fraud was still the exception, but the same manager explained that by 1995, this practice was more common. This claim is corroborated by the diagnostic performed by the new president named to Finansol in October 1995. His assessment discovered both "ghost groups" and self-lending (funds disbursed to loan officers themselves) in more than one branch, amounting to approximately C$200 million (just over US$200,000).

Other fraud germinated as a function of Agrosol's intrinsic logistical weakness. In distant communities without financial institutions, loan officers sometimes collected repayment directly from *colectivos*. When growth and supervision escaped control, however, it became very difficult to keep track of which groups actually paid. This situation opened the door to further instances of fraud. As mentioned above, the lack of supervision also gave rise to *colectivos* composed of members who did not meet requirements (for example, an entire group dependent on the same source of income). Such groups later contributed to Agrosol's serious delinquency problems. Although the full extent of such cases and others is difficult to quantify, their very existence is symptomatic of the degree of deterioration of Corposol's field operations.

PORTFOLIO QUALITY

Portfolio Characteristics

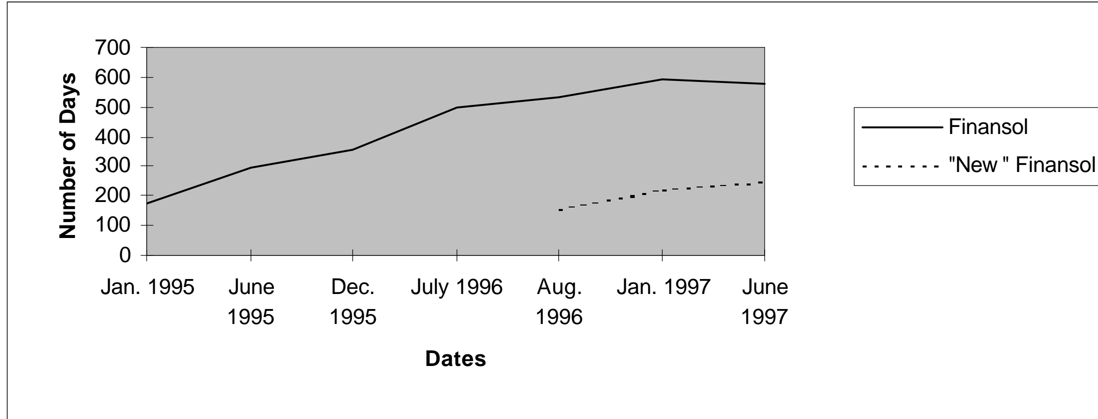
One of the central tenets in Corposol's step lending methodology is to begin with small loan amounts and short loan terms and progressively increase each as a function of responsible repayment, client needs, and repayment capacity. This is done in part to minimize risk, as each client begins as an unknown entity, and to help clients increase their scale of borrowing gradually. In offering new products, Corposol adjusted initial loan terms and amounts, the pace at which the terms and amounts were augmented, and other methodological variables

without fully analyzing the potential consequences. This section discusses each of these variables as background for the discussion of some of their implications.

Loan Terms

A microentrepreneur's cycle for investment in working capital, transformation and sale, consequent recuperation of investment, and generation of income is often quite short. Longer loan terms that are out of sync with a client's cycles can create a repayment risk. Yet, it is logical to issue loans for larger or longer term investments (such as Corposol's fixed-asset loans and Construsol's loans), as clients are often willing (and more able) to amortize the burden of paying for such an investment over a longer period. As a consequence, the loan terms of some of Corposol's new products were significantly higher than those of Corposol's solidarity group loans. As of January 1997, Construsol loans had an average term of 1,023 days, or nearly three years, while fixed-asset loans were not far behind, with an average of 872 days, or close to two-and-a-half years. By way of comparison, solidarity group loans had an average term of 241 days at that time, or about eight months, which itself is relatively high.[131] This brought the aggregate average term up to nearly 600 days, or about 20 months. Figure 16 shows the general trend in Corposol loan terms from January 1995 through June 1997.[132]

Figure 16: Trend in Aggregate Average Loan Terms, 1995-1997

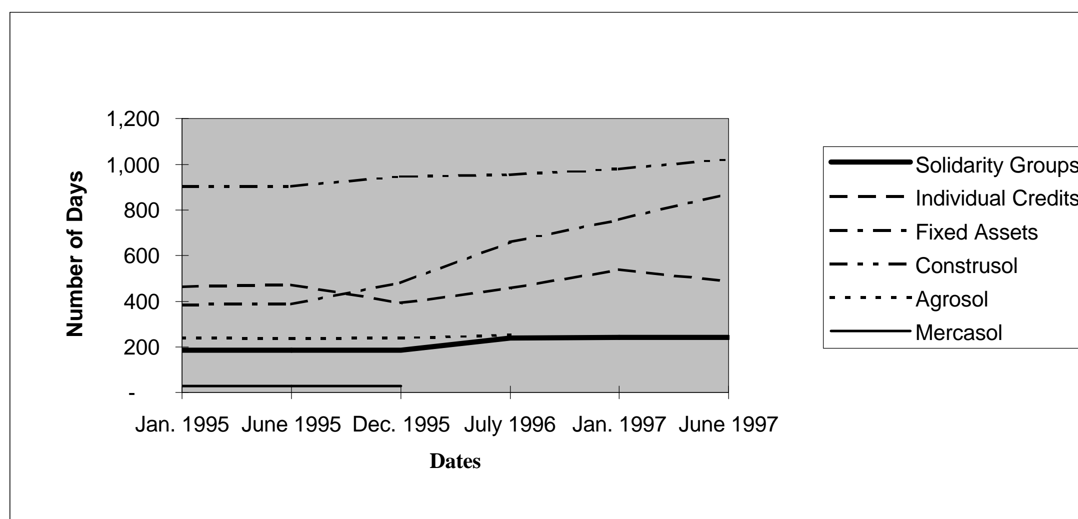


[131] Experience across microlending institutions suggest that an average term benchmark of four to six months for portfolios with primarily working capital loans is healthy, with some variation as a function of the age of the program and the maturity of the portfolio. Newer programs tend to have much lower averages, as a higher portion of their loans are with new clients, whereas older programs with clients who have longer credit histories may have higher averages.

[132] Detailed loan term information is unavailable prior to this date, although January 1995 is a reasonable starting point for evaluating the impact of new products on loan terms. Before mid-1994, the portfolio would have been primarily composed of Corposol's traditional loans, which are likely to have had average terms more similar to the benchmarks referred to above.

Moreover, even within certain products, loan terms rose during the same time period. Average fixed-asset loan terms more than doubled, from 385 days to the 872 days mentioned above. Figure 17 shows this trend by product.

Figure 17: Loan Terms by Product, 1995-1997



Analysis of this trend in its operational context suggests some possible explanations. When the new products were introduced, loan officers were held to performance objectives related to the number of loans they made in each type of product. At the same time, they could only make those loans to existing clients. One way of increasing the amount of debt each client could bear was to increase loan terms, thus reducing payment amounts by spreading them out over more time.[133] At the same time, the longer the term, the less frequently each loan had to be renewed. This reduced the time required of the loan officer and made it possible for them to handle the larger loads induced by performance objectives. These short-term solutions had longer term costs, however, as longer terms made some of the loans more difficult to recover.

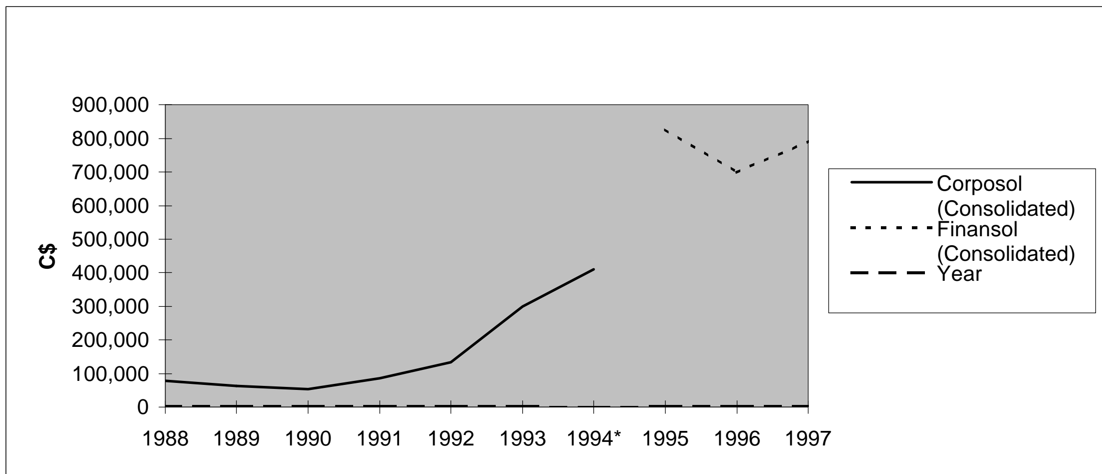
Note in Figure 16, on the previous page, the line defined as "New Finansol." This represents the average term of loans made since diagnosis of the crisis by the new president, who took over in the last quarter of 1995 and reflects the emphasis on returning to a proven methodology, which began in 1996. The dramatically reduced average term of these loans is evidence of the importance management places on this variable.

Loan Amounts

The new products also had a dramatic effect on amounts lent. As demonstrated by Figure 18, between 1988 and 1995, the average amount disbursed per credit increased by a factor of eight in nominal terms, with 63 percent of the total increase occurring from 1994 through 1995.

[133] This also helped the portfolio grow more quickly.

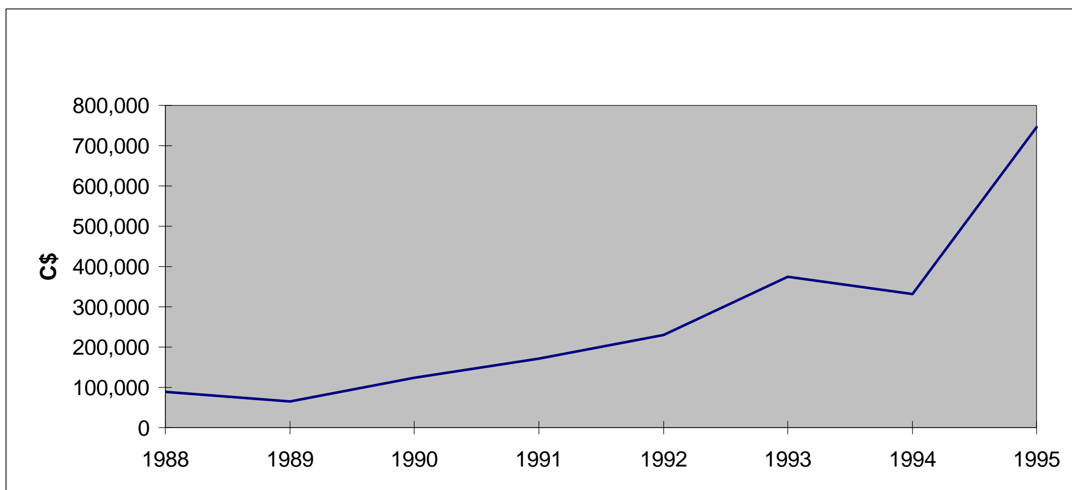
Figure 18: Average Amount Disbursed per Client



As early as 1989, Corposol's individual loans were disbursed with amounts averaging 3.65 times those disbursed to solidarity groups, and the differences increased significantly over time, especially among new products. By the end of 1995, Construsol loans were on average more than 4 times as large as Solidarity Group loans, despite the fact that these loans had increased by a factor of 10 since 1989.

The combined impact of the augmented sizes of some of the new loan products and the fact that many clients had multiple loans had a dramatic effect on the total debt burden per client. Figure 19 demonstrates that by the end of 1995, the total active portfolio per active client of Finansol was more than 10 times what it had been in 1988, with the most dramatic increase occurring from 1994 to 1995, when the loan amount per client more than doubled.

Figure 19: Active Portfolio per Active Client, 1988-1997

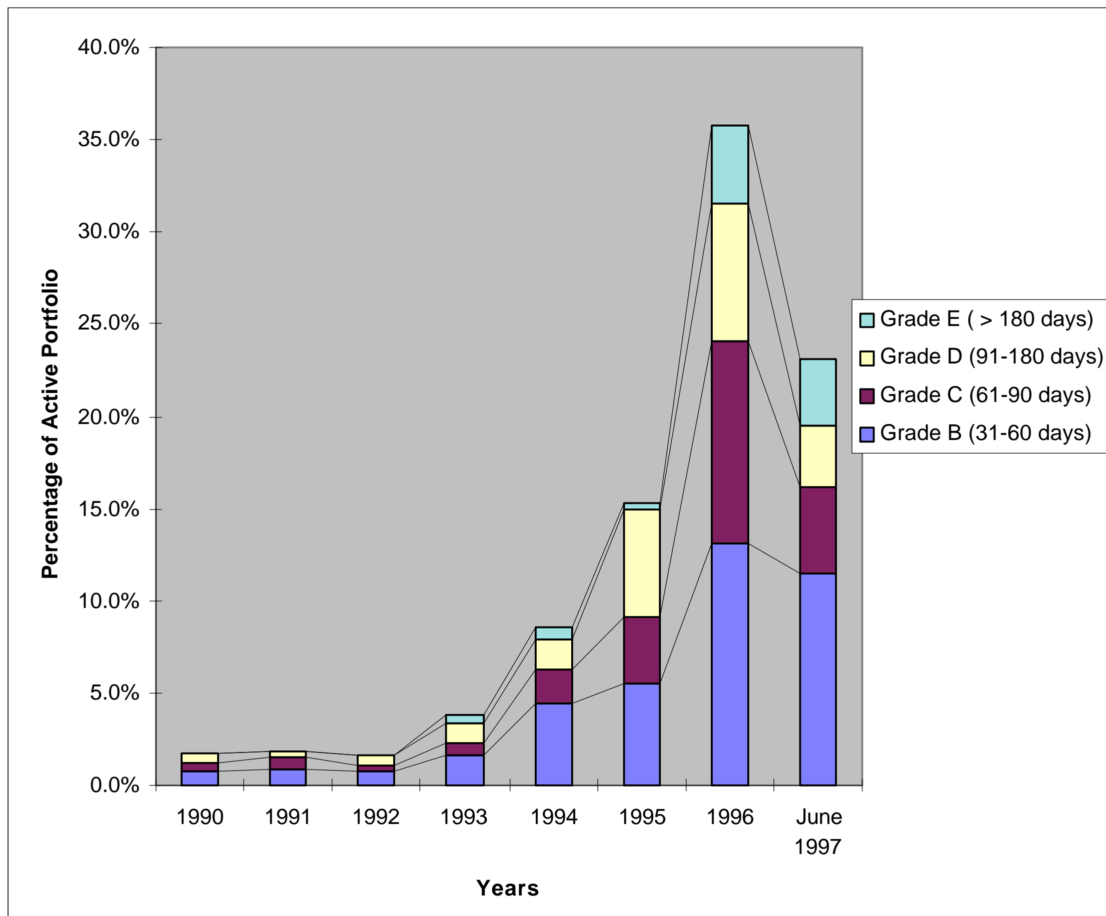


This trend represents a break from the built-in security mechanisms of gradual step lending. Unfortunately, loan officers were not provided with an adequate substitute (such as training in strengthened credit analysis). Thus, it is not surprising that this increase in debt led to repayment crises for many clients.

Delinquency

Figure 20 shows a steady increase in delinquency,[134] which began slowly with an increase to 3.4 percent in 1993, doubling previously stable levels of around 1.7 percent. The trend continued in 1994, with delinquency doubling to 8.6 percent by year end, then skyrocketing through 1995 to a high of 35.7 percent in 1996.[135]

Figure 20: Loan Delinquency over Time



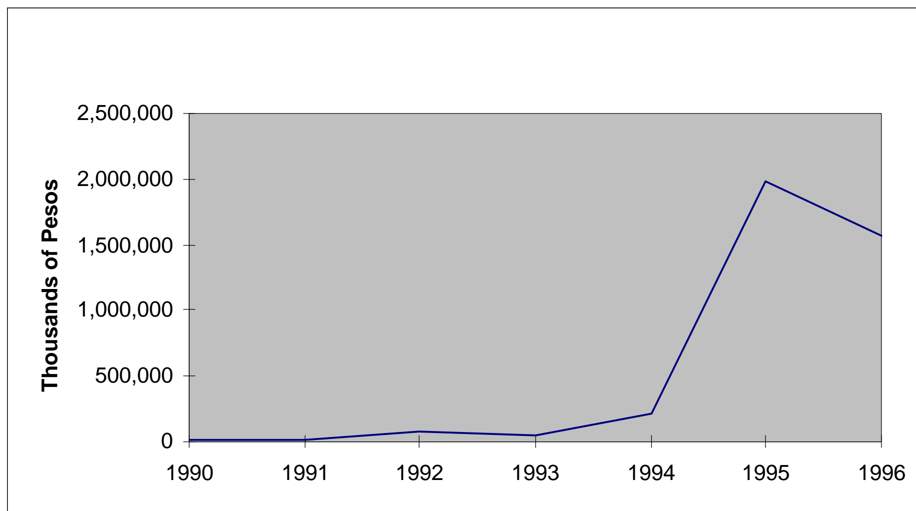
* 1990-94 = Gruposol portfolio; 1996-97 = Finansol only

[134] Delinquency is measured in terms of the total balances outstanding of loans with payments more than 30 days overdue, as a percentage of the total active portfolio.

[135] Note that actual levels of delinquency were higher than those shown, which do not reflect a quantity of bad loans that were refinanced or restructured (primarily during 1995 and 1996). Moreover, the inclusion of loans with late payments of less than 30 days, a standard managed by many institutions, would significantly increase this calculation of the percentage of Corposol's portfolio affected by delinquency.

Figure 20 also demonstrates that the gravity of the problem grew with the total delinquency level. Whereas from 1990 to 1992, an average of more than two thirds of Corposol's delinquency was considered Grade B or C (31-90 days overdue) and no loans reached Grade E (more than 180 days overdue), during 1995 and 1996, delinquent loans of Grades D and E (loans of 91-180 days and more than 180 days overdue) averaged 35 percent of Corposol's total delinquency. This is significant in that the longer a loan is overdue, the more difficult it is to recuperate. Figure 21 reflects the financial implications of this degeneration of Corposol's portfolio, expressed in terms of its provisions for bad loans.[136]

Figure 21: Provisions Made for Bad Loans: Gruposol

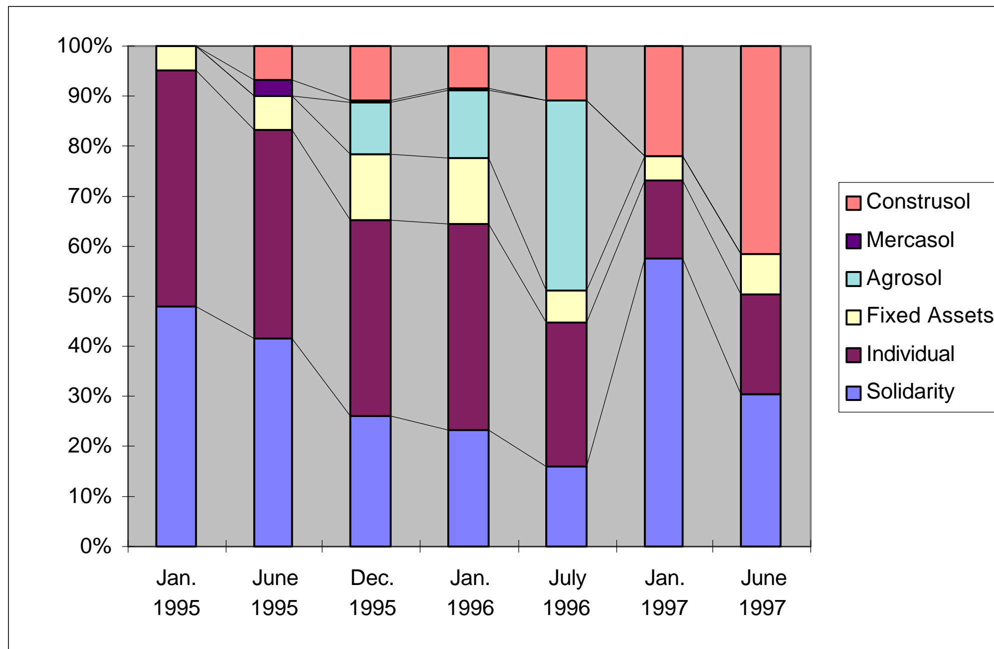


Note: 1990-1994 figures refer to Gruposol; 1995-1996 figures refer to Finansol only

To better understand the derivation of the increase in Corposol arrears, it helps to break them down by product. Figure 22 shows the percentage of total delinquency attributable to each product from January 1995 through June 1997.

[136] Provisions are an accounting term for the amount of money an institution "sets aside" to cover the potential amount of its portfolio which it will have to write off if it cannot recover its delinquent loans. They are calculated to reflect the estimated risk of the current portfolio, based on a certain percentage of the value of delinquent loans in each category, with the percentage increasing by Grade (because of the declining likelihood of loan recovery as a function of time overdue). On a regulated institution's income statement, provisions are reflected as an expense, thus reducing net income by the amount of the estimated risk.

Figure 22: Composition of Arrears: Finansol, 1995-1997



The percentage of total arrears from Solidarity Group loans declined from January 1995 through July 1996, as the relative weight of other products increased. At this point, Solidarity Groups accounted for only 14 percent of the total arrears, while representing 18 percent of the total portfolio. By comparison, Agrosol loans were responsible for 34 percent of Corposol's total delinquency, with 32 percent of the portfolio, and individual loans contributed 26 percent with 23 percent of the portfolio. The relative increase in the percentage of arrears because of Solidarity Groups thereafter can be attributed in part to the fact that mass write-offs during 1996 and 1997 eliminated certain products.

Unfortunately, the scale of lending in each product makes it more difficult to analyze the relative risk in an aggregate graph like the one above. Figures 23 and 24 offer another way to look at the behavior of each product. They show the percentage of portfolio within each product in arrears from January 1995 through June 1997.

Percentage of Product Portfolios in Arrears

Figure 23: Traditional Credit Lines

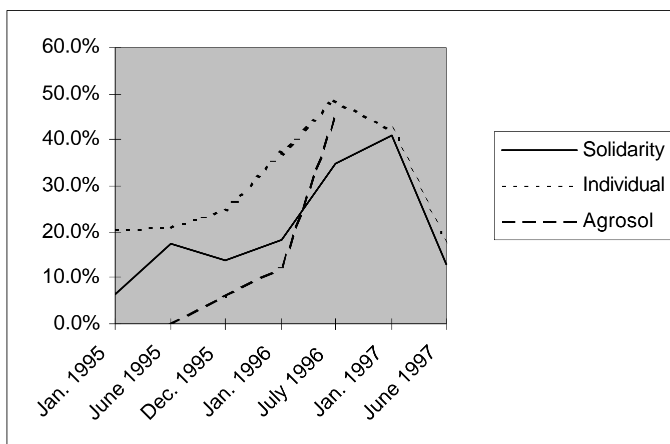
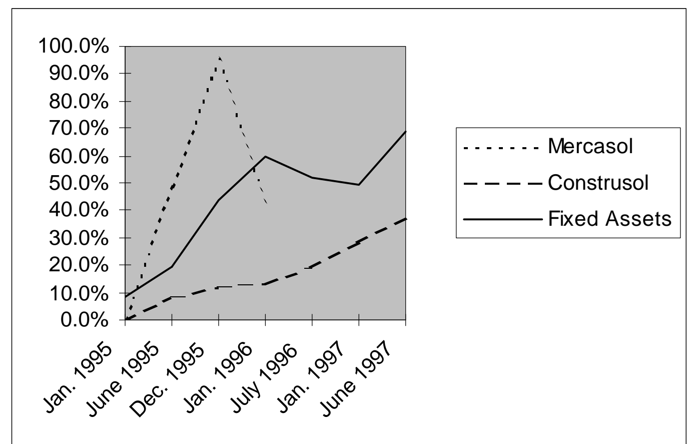


Figure: 24: New Credit Lines



The slopes of these lines coincide with the general trend of increasing delinquency discussed above. What these graphs portray that is not shown in the aggregate graphs is how high the arrears were within some of the small products. At its worst in late 1995, before write-offs in 1996 (as indicated by the sharp decline in the line), more than 95 percent of the Mercasol portfolio was in arrears. This suggests a significant problem with the product, despite the fact that the small scale of the Mercasol portfolio did not have much incidence in the status of Corposol's aggregate portfolio. The Agrosol portfolio reached a high of 45.5 percent and Individual loans were at 48 percent in July 1996, shortly before Corposol closed its doors. Worse, the percentage of delinquency in both Fixed Assets and Construsol loans were still on the rise as of June 1997, at 68.6 percent and 37.7 percent respectively.[137] At the same date, only 12 percent of the Solidarity Group portfolio was in arrears. Such figures lend credence to the view that Corposol's experimentation with new products without sufficiently developed methodologies had a significant impact on the degeneration of portfolio quality, and the ultimate collapse of the institution.

Personnel Strain

The combination of these circumstances, and the practice of firing employees who failed to meet performance expectations, generated staff turnover of staggering proportions. Although complete information is not available,[138] it is estimated that 104, 93, and 48 employees left Corposol[139] in 1993, 1994 and 1995 (through April), respectively. These numbers would suggest that 54 percent of the volume of employees hired in 1993 left the institution during the same year. Looking at the figures for 1994, the equivalent of 40 percent of Corposol's volume of employees at the beginning of the year left the institution by year's end. Even though this data is not precise, it still offers an important indicator of the seriousness of this issue.

The financial cost of this turnover in terms of recruitment, training, and the needed learning curve for replacements was significant. Moreover, the loss of continuity in client relationships likely affected client repayment and retention.

Beyond this tangible indicator of strain, there were immeasurable effects on employee motivation and productivity, as discussed in Chapter Four. The cost of such effects in any service organization can be significant, especially so in a microfinance institution given the

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[137] Note that part of this tendency can be attributed to the fact that as of 1996, no further loans were issued with these products. Thus, over time, as loans reach maturity, it is natural that loans that have not been repaid become a higher percentage of the remaining portfolio outstanding.

[138] Data on staff turnover reflect inconsistencies between sources, making it difficult to know exactly what was real. These figures come from a draft prepared by a Corposol employee as an input for the CAMEL performed by ACCION International in 1995. They do not included Mercasol and Finansol employees. Management would not permit circulation of this version, however, and required an adjustment prior to submission of the CAMEL team. As such, the numbers shown in the CAMEL supposedly include Finansol figures as well, but in some cases they are even lower than those of the version that excludes both Finansol and Mercasol, which suggests they may have been manipulated.

[139] Figures do not include Mercasol and Finansol. Please refer to explanation given in previous footnote.

integral role of the loan officer. In Corposol, these factors undoubtedly contributed to the downward spiral experienced in lending operations leading up to the crisis.

MANAGEMENT QUALITY

The combination of factors described in previous sections consolidated the president's power, while weakening the organization in other ways, with severe operational consequences.

- The president's cadre of "Yes Men" insulated him from any checks and balances, yet unfortunately deprived the holding company of necessary technical leadership.

- The marginalization of employees who asserted ideas or suggestions that did not directly follow his lead protected the president from challenges to his authority, but also cut off a source of essential input to good decision making. This set a discouraging precedent that eventually eliminated much essential communication from lower levels of the organization.

- The rejection of external technical expertise as a means of shielding Corposol from potentially critical eyes deprived the organization of constructive support for improvements.

- The use of fear as an external means of imposing control proved a far less effective motivator than positive mechanisms to empower employee's motivation. Moreover, by adding the destabilizing effects of stress and insecurity to the workplace, it damaged both team and individual performance. Worst, forced subjugation cut off staff initiative and precluded their full contribution.

On the operations side, poor practices such as loan restructuring, manipulation of statistics reported, unrealistic goals and under-analyzed speculative behavior had escalated to the point of collectively producing a downward spiral.

- Massive loan restructuring campaigns to camouflage arrears and the sale of bad loans to Corposol to reduce the impact of provisions of Finansol's bottom line did not hide problems for long, as such practices damaged client's repayment culture and led to further delinquency.

- Poor cash-flow management created liquidity problems that escalated to the use of donated project funds to cover operational losses, and fictitious reports to donors enabled the approval of additional projects,[140] despite the failure of previous projects.[141]

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[140] According to personnel in charge of writing proposals and reporting to donors, the Spanish government in fact approved nine new projects in 1996, at a time when Corposol could no longer even meet its payroll. Fortunately, funds were never disbursed.

[141] Many staff described being asked to participate in "theater productions" to portray the existence of unexecuted projects or invent reports to describe activities never implemented.

Eventually, personnel were enlisted from other departments to write more proposals with the hope that additional donations would keep the organization afloat.

- Frantic hiring of additional loan officers in hopes that volume would help generate income faster only led to an increase in operating expenditures and a reduction in productivity in the short term, as demonstrated by Figures 7 and 8 (see Chapter Four).[142]

- Stop-gap measures like Corposol's sale of assets to Finansol for an emergency infusion of cash (discussed in Chapter Four) abused the holding company structure and did not help an already struggling Finansol.

- Corposol engaged in real estate speculation in hopes of returns that would help cover its broadening operational gap.

All of the above are all examples of the dangers of excessive and unchecked centralization of control, which permitted both unwise managerial decision making and desperate behavior in search of remedies, which drove the final collapse of the organization. Although centralized control per se is not bad, the risk of abuse of such power is most acute when effective internal control, oversight, and governance are lacking.

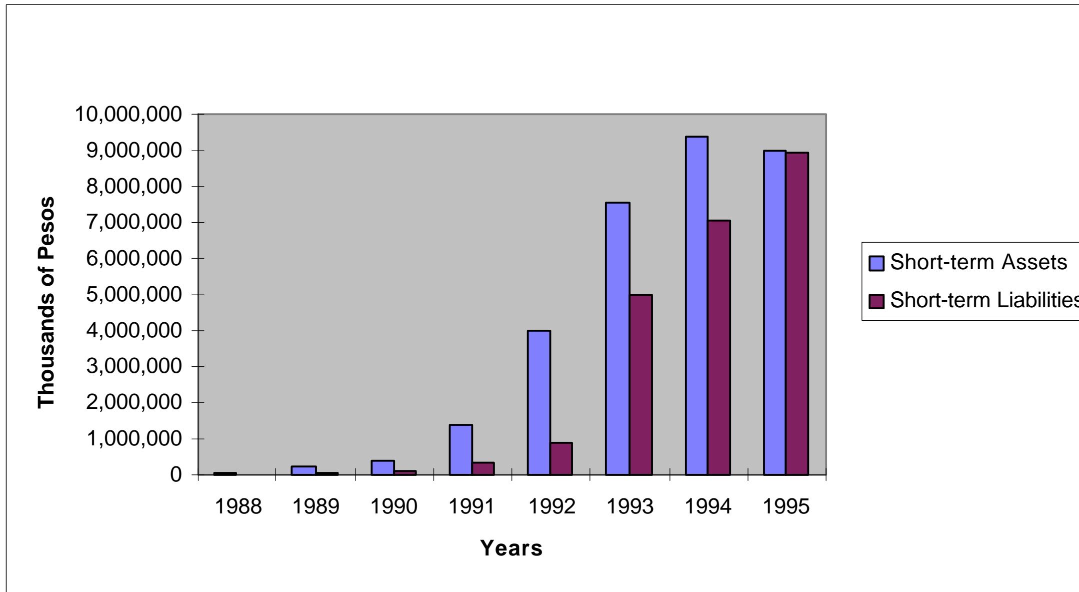
FINANCIAL STABILITY

It is beyond the scope of this document to pursue an in-depth analysis of the financial deterioration of the Corposol holding company. Yet a brief summary helps illustrate the potential weight of the issues discussed throughout this document: deterioration was the primary result of Corposol's growth generation and management flaws, which ultimately could not be ignored.

At the level of the holding company, a notable symptom of difficulties beyond the portfolio quality issues was the liquidity crunch that became apparent toward the end of 1995 and reached a critical point (in terms of the ability to meet basic operating expenses) in early 1996. Figures 25 and 26 show the evolution of Corposol's short term assets versus short-term liabilities and the resultant decline in liquidity as measured by the difference between the two.

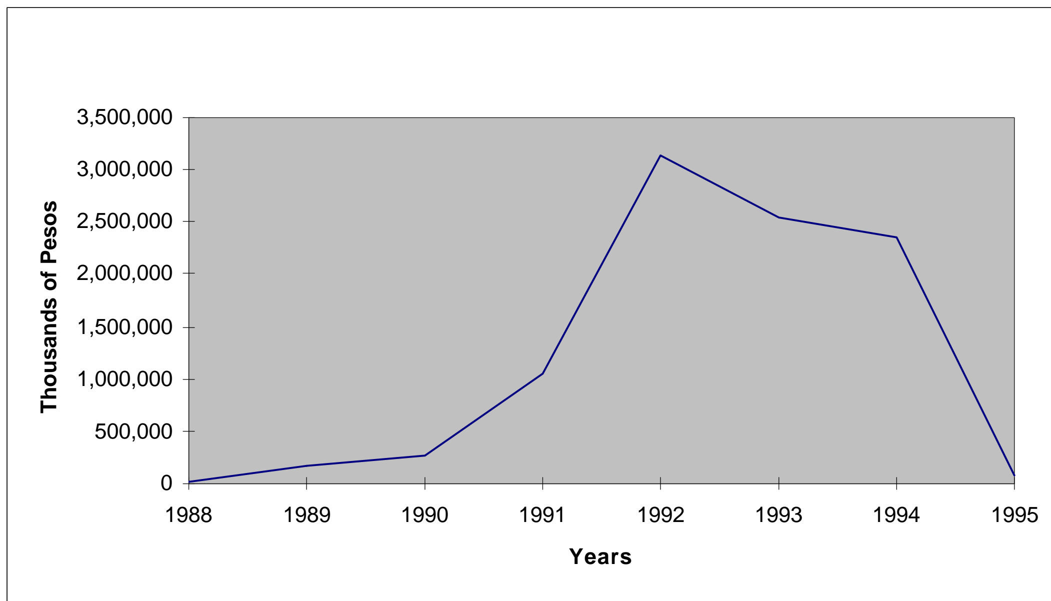
[142] This strategy was pursued to the point where selection staff scrambled to meet management- imposed volume requirements, only to be told on completion of the task that there was no longer money available for hiring. As candidates had already passed through extensive screening and training processes, this represented a considerable investment, as well as an indicator of management decision making not sufficiently grounded in reality.

Figure 25: Short-Term Assets vs. Liabilities: Corposol 1988-1995



Short-term assets include caja y bancos, short-term investments, deudores a corto plazo.
Short-term liabilities include sobregiros bancarios, short-term obligation with financial institutions, fondos en administración, vinculados económicos, cuentas por pagar, taxes, prestaciones sociales, y provisiones/cotigencias.

Figure 26: Change in Working Capital: Corposol 1988-1995



This decline in liquidity was merely one tangible outcome of the deterioration, however. To take a deeper look at the underlying trajectory, this section focuses on the financial evolution of Finansol as the core business unit. Although Finansol represents only a subset of the activities of the holding company, it reflects the most concrete basis for assessment of financial health. Finansol held most of the aggregate portfolio; its accounting reflected more

real costs in terms of cost of funds, provisions for portfolio risk, and adjustments for inflation; and its income was derived from operations rather than grants and projects, as occurred in Corposol. Most importantly, as Finansol (now known as Finamérica) is the only component of the holding company still in operation at the time of this study, its trajectory also reflects the recovery.[143]

Changes in the composition of Finansol's balance sheet and the evolution of its income statement illustrate the effects of strategies discussed in previous sections, and their impact. The deterioration can be traced as follows:

- As of December 1994, Finansol's portfolio, its primary productive asset, represented 80 percent of its total assets. In 1995, the CFC's total assets increased dramatically; yet as of the end of that year, the share of those assets because of portfolio declined to 64 percent, as a significant portion of the apparent growth came from the purchase of a large, unproductive asset.[144] Thereafter, the portfolio's percent of total assets continued to decrease, even while both were declining in absolute terms. This trend continued until mid-1997, when the unproductive asset was sold, and both portfolio and asset growth began to turn around. These dynamics are reflected in Figures 27 and 28.

Figure 27

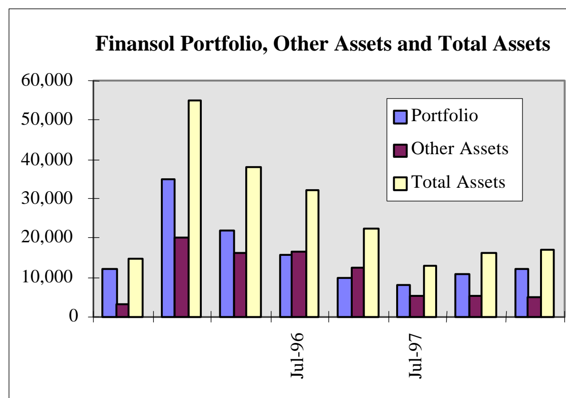
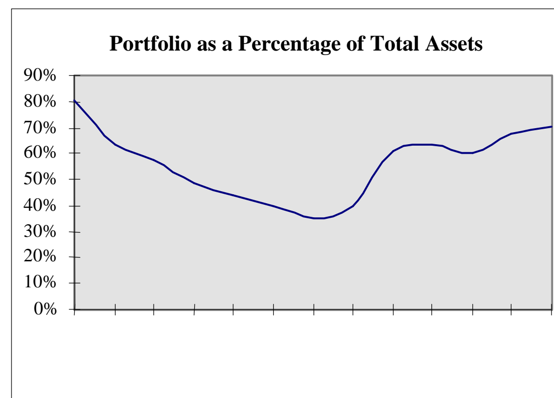


Figure 28



- As Finansol's portfolio declined, so did its operating income. Yet costs did not decrease accordingly. Figure 29 shows how Finansol's gross operating margin[145] declined from 51 percent in 1994 to 19 percent at the end of 1995, to a negative relationship by mid-1996. Figure 30 reflects net income during the periods shown, along with accumulated losses. Note, however, that since August 1997 Finamérica has enjoyed positive and increasing net income for the first time since the creation of the CFC, testifying to the turnaround.

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[143] The source of the following analysis is an historic financial statement comparison, compiled by the president of Finamérica at the time of this study.

[144] Said asset was a piece of real estate, as discussed earlier.

[145] This reflects operating income net of financial costs and fees, but before other operating expenditures, such as personnel costs, provisions, and so on.

Figure 29

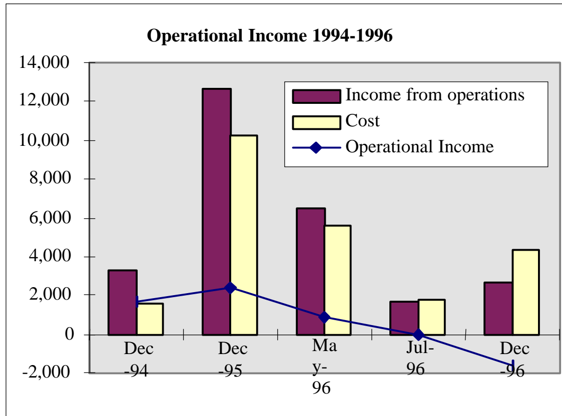
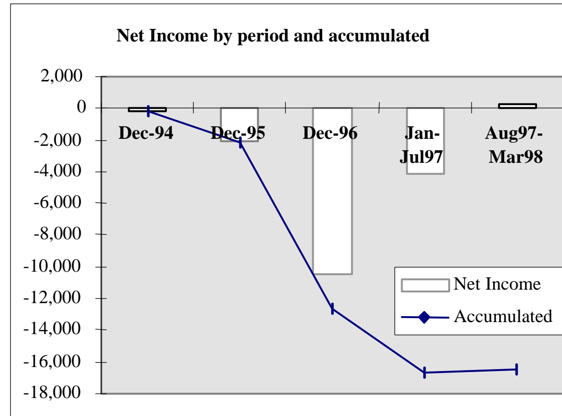


Figure 30



- Given Finansol's lack of operational income, it is not surprising that the growth in assets reflected above was financed primarily with debt, as demonstrated by the dramatic increase in liabilities from 1994 to 1995 (see Figure 31). At the same time, Finansol's equity as a percent of total assets declined from 29 percent in 1994 to 13 percent in 1995, reaching a low of less than 1 percent in July of 1996 (see Figure 32 below). Thereafter, the CFC was recapitalized, returning equity to 31 percent of total assets by December 1996. Despite this infusion, Finansol's net equity continued to deteriorate through mid-1997, primarily because of the combined impact of operational losses and provisions for unrecoverable loans. From the fourth quarter of 1997 through the time of this study, however, Finansol's equity had been consolidated and ranged from 30 to 32 percent.

Figure 31

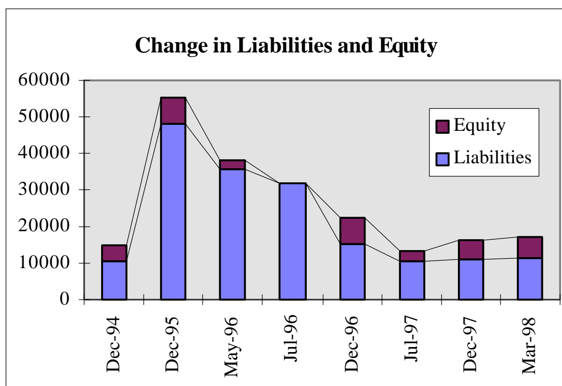
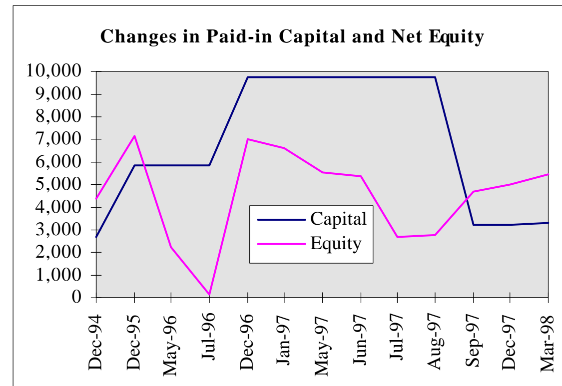


Figure 32



In sum, although the full consequences of the flaws in Corposol's growth generation and management discussed throughout this study may not have been fully perceived in the early stages of the organization's development, the present analysis shows that together they had an undeniable cost. It also demonstrates that with tools of disaggregated, transparent financial analysis, undesirable trends can be identified and provide inputs for healthy management.

CHAPTER SIX: LESSONS LEARNED

With hindsight, a clear set of factors contributed to Corposol's dramatic trajectory. Yet during the critical years when steps might have been taken to sustain the institution, neither the implications of Corposol's growth-generation strategies nor its deficient organizational capacity was so evident. In hopes that understanding this experience can help other institutions pursue sustainable strategies, this final chapter summarizes the conclusions to be drawn from each of the areas analyzed in this study and outlines possible measures that may help other institutions avoid Corposol's experience.

GROWTH-GENERATION STRATEGIES

Observation

Intensive growth via careful zone management initially allowed Corposol concentrated market penetration, which facilitated operational control and loan officer productivity. But failure to recognize and adapt to limits of the strategy curtailed its efficacy

Recommendations

- Be attuned to market saturation. Redefine zones as required to ensure each loan officer sufficient, independent, and concentrated territory, allowing for optimal productivity and preempting loan officers' need to stray beyond defined zones or relax lending standards in search of new clients.

- Govern zone transference and growth frequency to safeguard continuity in client relationships.

Observation

Active management of productivity primarily via application of performance objectives for field staff induced growth throughout Corposol's tenure. Yet, the structure and level of goals together with enforcement strategies ultimately drove undesired lending behavior.

Recommendations

- Balance institutional priorities when defining performance objectives to ensure that new lending is healthy and sustainable. Accompany rewards for growth in clients and lending with penalties for poor portfolio quality and client desertion to reinforce prudence. Weigh

the risks and rewards of short-term portfolio-driven growth versus longer term growth via client development.

- Set realistic goals based on historic performance to ensure objectives can be met without sacrificing operating standards.

Observation

After an initial phase of intensive urban market penetration, rapid geographic expansion allowed Corposol to augment its client base dramatically via its presence in new urban, suburban, and rural markets. Yet, operations were not equally successful in all of the new markets, representing costs that might have been avoided.

Recommendations

- Analyze markets to ensure sufficient client demand exists in the desired sector and to avoid areas with significant known risk factors or other considerations likely to limit the volume or quality of lending.

- Plan expansion carefully to minimize subsequent closing or moving costs.

- Define expansion feasibility in conjunction with assessment of staff sufficiency, from a *load* relative to *capacity* perspective, as well as with regard to supervisory/oversight capacities.

Observation

Product diversification appeared to offer new avenues for growth while meeting a broader range of client needs. Yet, the structure and policies that governed the new products induced the practice of giving multiple loans to the same clients, augmenting the risk of over-indebtedness. Moreover, the new (unproven) products cannibalized existing lending and reduced portfolio stability.

Recommendations

- Analyze strategic initiatives relative to market demand to anticipate potential impact on aggregate goals. Assess all identifiable costs and benefits to permit management of related tradeoffs like risk.

- Keep the client’s best interests (i.e., maximum repayment and debt capacity and true financing needs) in mind while developing initiatives to meet institutional objectives.

Develop policies and procedures to support staff efforts that safeguard the former while supporting the latter.

ORGANIZATIONAL DEVELOPMENT FOR GROWTH MANAGEMENT

Staff Development

Observation

Gradual, controlled hiring of loan officers and careful, personal development yielded effective field staff in Corposol's first years of operations. Yet, subsequent hiring volume exceeded the training, mentoring and supervisory capacity of experienced staff and resulted in a decline in lending consistency. Moreover, the rapid influx of new loan officers lowered aggregate productivity, augmenting field operation costs.

Recommendations

- Manage not only the number of loan officers required to handle a given volume of clients, but also the number of new loan officers that existing supervisory capacity can effectively bring into the fold.

- Develop complementary or alternative means of ensuring consistent training and follow-up if staff growth overwhelms the efficacy of personal, informal measures.

- Allow market demand to drive hiring practices to keep operational costs in line with income generation.

Observation

Early success in field operations gave management confidence in later reliance on quantitative performance indicators, as increasing decentralization and competing priorities shifted attention from hands-on field oversight. Lulled by positive results, management failed to notice the dispersion of lending practices that permitted those results, until deviations were entrenched and hard to correct.

Recommendations

- Establish central office and branch-level mechanisms for ongoing quality control of field operations to permit diagnosis of the first signs of problems, when they are easier to address.

- Prioritize investment in standardizing credit policies, operating procedures, internal controls, and oversight before operations reach a critical scale, and ensure unified application of norms during expansion. Growing with consistent parameters can help avoid the far greater cost of attempting to change varied practices later.

Observation

The combination of holding staff accountable to stringent performance objectives, while failing to operate as a true meritocracy at many levels of the organization, was a source of cognitive dissonance for staff, reducing their motivation and respect for management.

Recommendations

- Define and apply consistent, transparent performance evaluation criteria to avoid uncertainty or ambiguity.
- Link positive performance clearly to rewards, and employ analysis of poor performance as an input for feedback and subsequent follow-up, to emphasize positive over negative reinforcement.
- Hire, fire, and promote via clearly defined, transparent, and objective parameters to ensure staff motivation, respect for supervisors, and accountability yet security in their positions, as well as their professional efficacy.

Observation

Although Corposol's initial staff was highly effective in fulfilling the responsibilities of their original functions, new challenges arose over time with the organization's changing scope, augmenting the demands on staff. Corposol did not adequately develop its personnel to respond to those challenges, leaving gaps at many levels of the organization.

Recommendations

- Define the profiles and skill sets required by personnel at all levels of the organization, as a function of the responsibility of each.
- Develop job-specific training to prepare internally promoted professionals to assume new responsibilities and help externally hired professionals familiarize themselves with the characteristics of microfinancial service provision that affect their roles.
- Anticipate the need for new skills as a result of new initiatives or other changes that require adjustments by employees, and implement proactive training.

Organizational Design

Observation

Corposol was successful in achieving increasing economies of scale during the first several years of its trajectory. Yet, creation of the holding company failed to achieve anticipated economies of scope, rather resulting instead in lost efficiency, ambiguity in management of lending operations, and conflict of interest and standards between for-profit and not-for-profit components of the institution.

Recommendations

- Leverage administrative structures where possible, but recognize where new capabilities need to be developed.
- Clearly delineate new functions, positions, or other changes in organizational structure clearly, defining roles, responsibility, authority, and accountability to avoid redundancy, ambiguity, or gaps in functioning.
- Commit to transparent financial management as a tool for ongoing quality control and long-term stability.
- Secure operational independence of regulated entities to permit corresponding objectivity in decision-making.

Observation

Corposol's president used highly centralized control to mobilize and orchestrate the institution's impressive growth, an approach that afforded cohesion of activity when the organization was small. Yet, effective extension of his authority as the institution grew would have required development of more coherent structures to that end. The absence of such structures left gaps in information flow, inhibited good decision making, limited middle management efficacy, and left certain operations vulnerable to inconsistency.

Recommendations

- Accompany new hierarchical layers with mechanisms for multidirectional communication to ensure that management decisions are made with sufficient knowledge of operations, and that such decisions are consistently communicated, understood, and applied at all levels.

- Structure internal controls to reduce flexibility in financial management to ensure operational consistency and minimize opportunities for lapses in personal integrity.

- Create checks and balances throughout the organization and at the board level to support optimal decision making. Develop delegation and supervisory mechanisms to set and enforce good goals, standards, and practices to make the most of personnel contribution and results.

Observation

Pursuit of ideas for new initiatives, which outpaced institutional capacity for analysis, planning, and preparation of the organization before their execution, not only limited the success of those initiatives in Corposol, but also ultimately proved a critical destabilizing factor. The high cost in terms of portfolio quality, staff strain, and up-front investment in businesses with unproven financial viability far exceeded the benefits of their accelerated launch.

Recommendations

- Establish processes and build skills for integral analysis of the potential cost/benefit of new initiatives to ensure full assessment of market demand, identification of potential risks and operational implications, and strategic prioritization.

- Develop ideas with prudence, dedicating staff time to pilot, monitor, and adjust initiatives before institution-wide launch.

- Pursue integral planning for implementation, to ensure input from each functional area about the support structures and preparation required to handle new responsibilities.

- Commit the necessary time and resources to putting those elements in place. Consider adequate preparation an investment in future stability of the program, rather than a cost.

Institutional Culture

Observation

Corposol's client service mission was one of the most powerful, unifying, and motivating elements of its culture from the inception of the organization. Yet, loss of clarity in institutional priorities and values eroded that unity of purpose among staff and management, which then contributed to the loss of consistency in behavior and operations.

Recommendations

- Define institutional mission and vision. Prioritize communication and continually emphasize these ideals at all levels of the organization.

- Be attuned to signs of variation in value constructs which affect operational behavior, taking care to ensure that consistency starts with management.

- Create forums to review the degree to which mission and vision remain a governing force in the organization, and define desired adjustments or necessary reinforcement of original ideas.

Observation

Strong executive leadership created a charismatic momentum that helped Corposol make impressive strides. Yet, the destructive means by which the president consolidated and exercised his power ultimately curtailed the potential strength of the organization.

Recommendations

- Develop strong middle and upper management and empower them to maximize what each can contribute to the team and its results. A weak or subservient team may not threaten its leader but is less able to add value.

- Establish parameters and goals to guide operations, but do not micromanage. Undermining middle-management authority precludes effectiveness and reduces motivation.

- Set standards and live by them. Contradictions in managerial behavior create cognitive dissonance and encourage employee interpretation of norms and values.

Observation

The explicit priority Corposol placed on excelling in the public eye initially helped inspire employee performance, while building the credibility to access funding, for example. But as Corposol's image grew rosier than its operations, protection of that image required excessive pressure on branch performance, and later, misrepresentation of statistics, refinancing to hide portfolio deterioration, and so on. This pattern set a destructive precedent in the implicit valuing of image over substance even at the cost of prudence, which subsequently filtered through personnel behavior and integrity.

Recommendations

- Celebrate success, but be realistic about the scale of future expectations to preempt pressure on field operations that would compete with good lending standards.

- Be transparent within and beyond the institution. Acknowledge and deal with weaknesses before they get worse. Manage statistics in the strictest manner possible to permit early detection of problems like delinquency. View concerns and criticism from personnel, board members, or independent third parties as relevant insights for ongoing improvement rather than threats.

- Create an environment of open communication and trust by rewarding staff for transparency and honesty to ensure complete information and feedback. Personnel who fear retribution for failure will conceal problems rather than seek support.

Observation

Corposol management's early attention to personnel commitment and motivation generated an inspired, hard-working, mutually supportive team. However, as management focus shifted to new initiatives, pressure for exponential performance and later preoccupation with managing the operational and financial crises, personnel needs went unrecognized or insufficiently prioritized. Yet, ultimately, insufficient attention to the growing personnel crisis further fueled the operational crisis in multiple ways. The implicit "survival of the fittest" mentality bred insecurity and fear, which drove poor lending practices, while deteriorating motivation eroded productivity. Worse, morale proved difficult to turn around.

Recommendations

- Understand the impact of work environment on employee morale, motivation, and performance. Listen to warning signals. Anticipate the personnel side of organizational challenges and proactively address change.

- Recognize that the means used to promote a desired behavior affect the outcome. Positive reinforcement both rewards and empowers, building employees' sense of security, morale, and performance drive. Negative tactics, such as pressure for performance via fear of punishment, may induce temporary compliance but ultimately generate stress, resentment, and insecurity and reduce motivation. These two approaches have opposite effects on long-term stability of the workforce. Similarly, reinforcing intrinsic motivation (i.e., commitment to the institutional mission) is a powerful counterpart to external enforcement (via incentives or punishment).

- Encourage and reward team collaboration and responsibility along with individual performance to avoid individualistic behavior.

- Manage communication about challenges and change in a direct, controlled fashion to avoid employee speculation and uncertainty.

Observation

Establishing for-profit entities within the Corposol holding company and hiring external professionals to support those efforts resulted in conflict over cultural differences and affected operations. Lacking effective conciliation, these differences remained negative rather than additive, ultimately depriving Corposol of rich potential complementarity.

Recommendations

- Identify existing sources of variation in institutional culture. Seek means to understand and reconcile differences, and when possible, harness them; discover ways in which the whole can be greater than the sum of its parts.

- Recognize that any paradigm shift in strategies, operations, personnel, or other critical part of an organization's functioning can affect institutional culture. Anticipate that impact, develop a strategy to incorporate the change with minimal shock to existing systems, and communicate consistently throughout the organization.

THE ROLE OF AN APEX INSTITUTION: ACCION INTERNATIONAL

Corposol was an affiliate of the ACCION International network from its inception as Actuar Bogotá. Lending began with the solidarity group methodology used by many affiliates, and ACCION was involved to varying degrees in the boards[146] and in providing technical assistance throughout the institution's tenure. As such, one might ask how the situation in Corposol could deteriorate to the degree it did without earlier intervention by ACCION, as one of the entities that knew Corposol best.

With the wisdom of hindsight, ACCION management would have chosen to play a stronger role earlier in Corposol. Yet this vision was not so clear-cut as events unfolded during 1993 and 1994.

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[146] ACCION was a member of the board of Actuar Bogotá until late 1992 when the organization's statutes were changed, reducing the number of members. ACCION later invested in Finansol and became a member of its board. ACCION did not participate in the board of the Corposol holding company until invited to attend in 1996 as part of the crisis-resolution process.

- A fundamental concept behind the ACCION network was the idea of establishing strong, independent local institutions. This meant that ACCION's potential contribution was subject to definition with local management.[147] Along with other third-party professionals, ACCION staff identified certain organizational and operational weaknesses as part of technical assistance efforts or consultancies during those years. Respect for the discretion of local management in choosing to make adjustments or not, however, precluded more significant action at that time. More important, ACCION representatives who expressed misgivings at the board level in Finansol were an insufficient voice on that board[148] and without a voice in the controlling Corposol board.

- At the same time, Corposol's impressive track record and ambitious initiatives gave it a high profile as an institution with a lot to contribute to the ACCION network and to the microfinance industry in general. The organizational structure of the holding company confused detailed tracking of performance, but aggregate statistics were strong and backed by the credibility of a clean audit by a reputable "Big-Six" accounting firm. Essentially, lulled by Corposol's apparent success, ACCION did not persist strongly enough in its requests to perform a CAMEL diagnostic earlier.[149]

By the time the CAMEL diagnostic was performed in May 1995, Corposol's crisis had already taken root. Even with financial data only through December 1994, the team detected a series of organizational weaknesses and signs of financial deterioration. The issues uncovered were presented to the board, which was their first warning signal of the crisis. While this presentation mobilized the board to begin to address the problems, in hindsight, the issues uncovered were not presented as forcefully as was needed. For reasons discussed earlier, ACCION was unwilling to enter into an open confrontation with the board and management.[150] Soon thereafter, the true magnitude of the problems could no longer be denied.

ACCION offered unlimited support within its means to Corposol's crisis, through efforts that ranged from mobilizing the recapitalization efforts to providing ongoing technical assistance in redesigning Finansol's field operations. Working with many others, ACCION has helped to give Finansol another opportunity to continue to meet the needs of poor and marginalized microentrepreneurs in Bogotá. Despite this success, the broader Corposol crisis confirms the importance of a governance structure with checks and balances that safeguards integrity in ensuring the future functioning of microfinance institutions.

Most important for ACCION, this trajectory with Corposol yielded a lesson that has helped define the boundaries of network affiliation. While ACCION's respect for an affiliate's self-determination and its assumption of good faith made ACCION reluctant to be confrontational

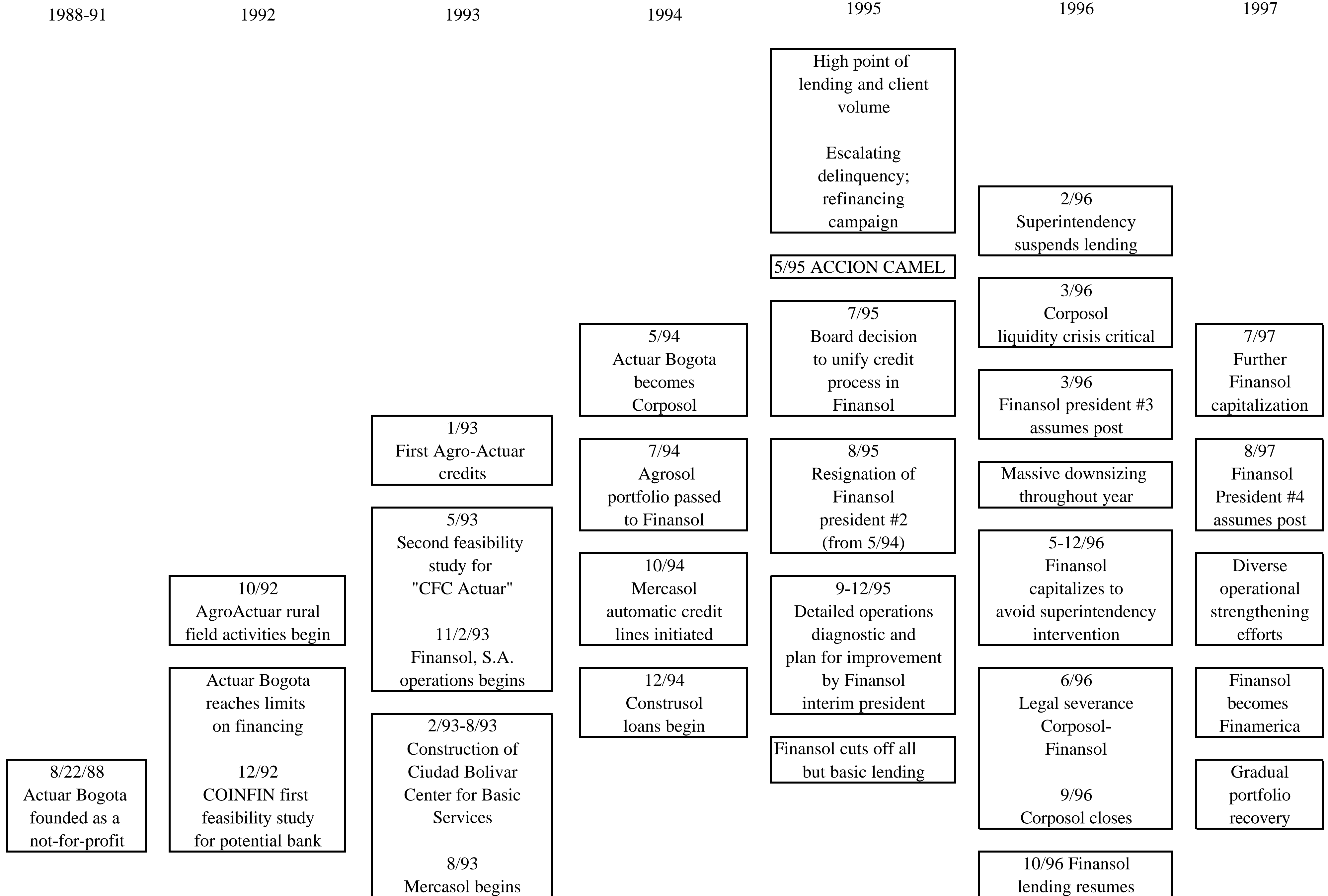
[147] One hallmark of ACCION's relationships with its affiliates has been respect for independent institutions with local roots based on voluntary affiliation and consequent deference to the preferences of local management for the level of support they request from ACCION.
[148] As discussed in Chapter Four.
[149] As soon as the CAMEL tool (ACCION's quality-control instrument (described in Chapter Two), was launched in 1993, ACCION was interested in applying it in Corposol. Related negotiations were pursued throughout 1994, but the diagnosis was continually put off by Corposol management.
[150] See Chapter Two for more detail on the conclusions of the CAMEL team.

with Corposol, this experience shows that ACCION must be willing to exercise disaffiliation as a tool of last resort when the bond of trust it shares with an affiliate has been compromised.

ANNEX A

TIMELINE OF EVENTS

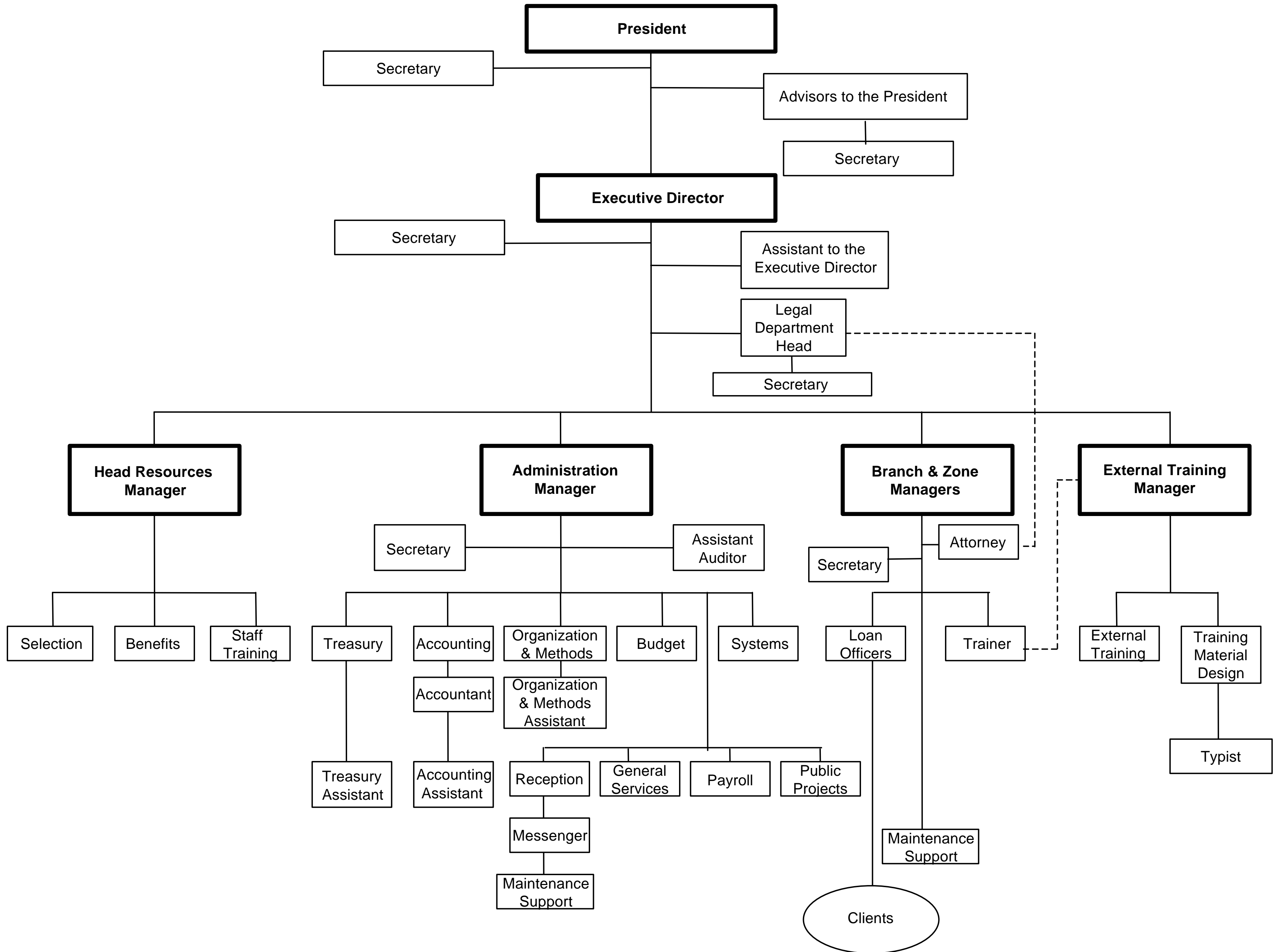
TIME LINE OF EVENTS



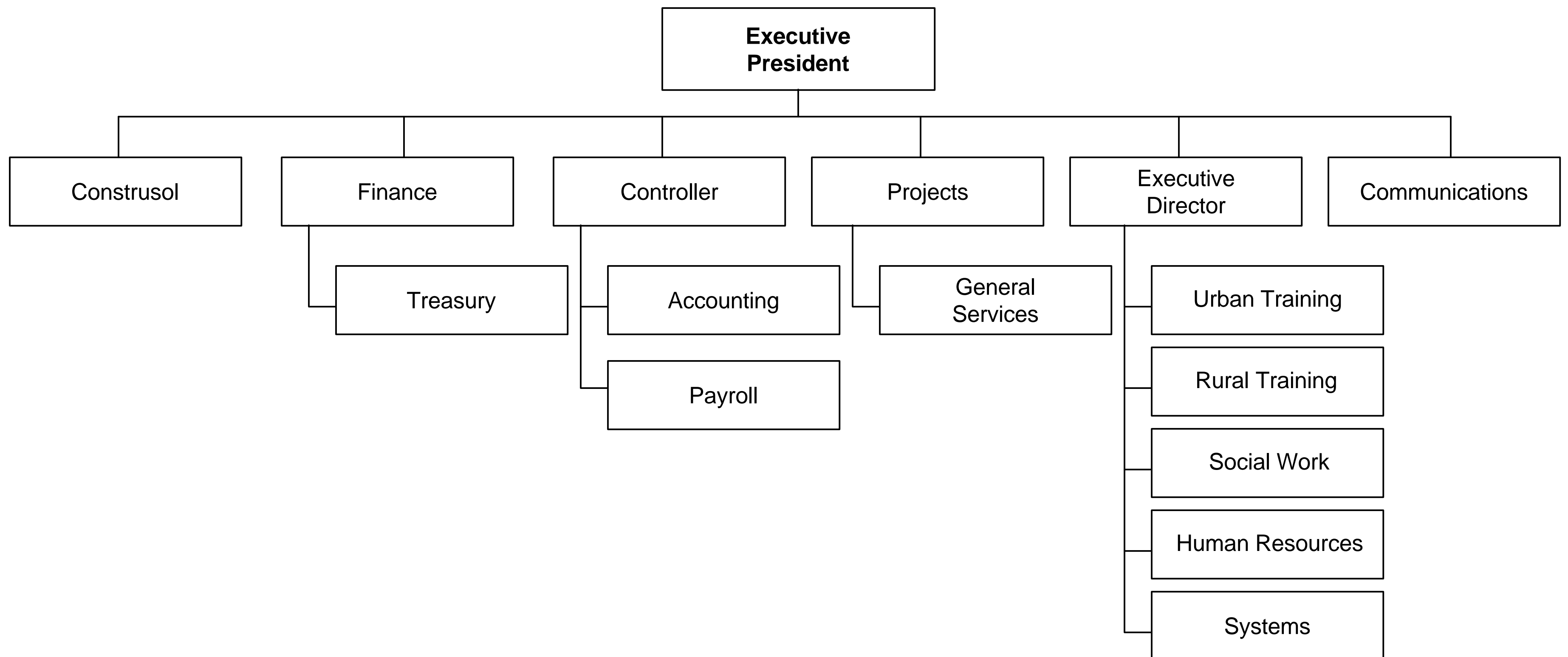
ANNEX B

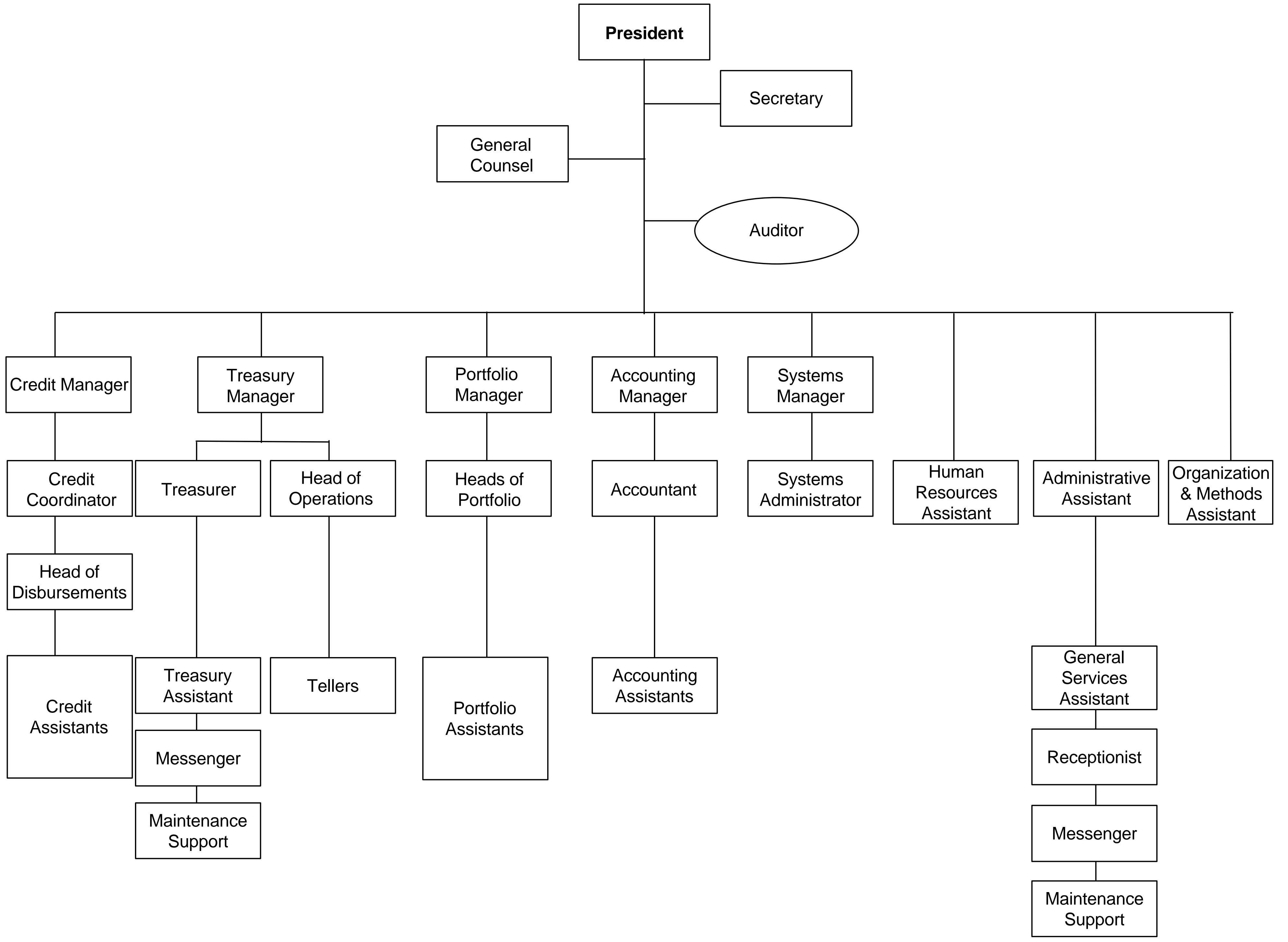
ORGANIZATIONAL CHARTS

Corposol as of June 1994



Corposol as of August 1995





Finansol as of September 1994
President
Secretary
General Counsel
Auditor
Credit Manager
Treasury Manager
Portfolio Manager
Accounting Manager
Systems Manager
Credit Coordinator
Treasurer
Head of Operations
Heads of Portfolio
Accountant
Systems Administrator
Human Resources Assistant
Administrative Assistant
Organization & Methods Assistant
Head of Disbursements
Credit Assistants
Treasury Assistant
Tellers
Portfolio Assistants
Accounting Assistants
General Services Assistant
Messenger
Maintenance Support
Receptionist
Messenger
Maintenance Support

Finansol as of September 1997