Consultative Group to Assist the Poorest (CGAP)
Working Group on Savings Mobilization

BANCO CAJA SOCIAL (BCS), COLOMBIA (CASE STUDY)

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CONTENTS

ABBREVIATIONS

ATM	Automatic Teller Machine
BANCOLDEX	Banco Colombiano de Exportación
BMZ	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung
CDT	Certificado de Depósito a Tiempo
CGAP	Consultative Group to Assist the Poorest
COP	Colombian Peso
DANE	Departamento Administrativo Nacional de Estadística
DAT	Depósito de Ahorro a Tiempo
FEN	Financiera Energética Nacional
FINAGRO	Fondo para el Financiamiento del Sector Agropecuario
FOGAFIN	Fondo de Garantías de Instituciones Financieras
GAP	Gestión de Activos y Pasivos
GDP	Gross domestic product
GED	Grow Every Day
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
IFI	Instituto de Fomento Industrial
MIS	Management Information System
NGO	Non-governmental organization
PIN	Personal Identification Number
VAT	Value added tax

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1 CONTEXT

1.1 Macroeconomic context

Colombia's economy is still struggling to get back to the steady growth path of the 1970s. Since the 1980s, years with high growth rates have been followed by severe recessions. After having liberalized the economy in the early 1990s, which produced stable annual growth rates superior to 5% since 1993, the economy was again depressed in 1996 with GDP expanding by only 3%. As a consequence of the liberalization of the economy in the early 1990s, private consumption was fueled and the national savings rate dropped from 21.4% in 1990 to 17.5% in 1996. Though the gross investment rate increased from 14.0% to 21.1% in the same period, private investment has remained at a low level. In the presence of overall economic instability, the unemployment rate peaked at 11.5% in 1996 after having dropped to 7.6% in 1993. However, restrictive monetary policies lowered the annual inflation rate from 32.4% in 1990 to 21.6% in 1996.[1]

The composition of the GDP is similar to that of industrialized countries. The service sectors contributed 54% to the GDP in 1994, an increase of 5% from 1980. The industrial sector remained constant at 32% during the same period while the agricultural production fell from 19% to 14% (World Bank 1996). The main export products are coffee, oil and minerals. Colombia is the Latin American country with the largest mineral deposits, gem and oil reserves; all show good perspectives for further growth.

The nominal per capita yearly income of US$2,262 in 1996 disguises the strong income disparities that exist in the country. The Gini-Index, however, shows that the richest 20% of the population obtains 55.8% of total income while the poorest 20% of the population only holds a share of 3.6% (World Bank 1996).

However, the country suffers from two major problems that may undermine constant growth. First, some regions are permanently threatened by guerrilla activities. Second, the narcotics business has a strong impact on the economy, artificially boosting specific economic sectors and exerting constant pressure on the inflation process.

1.2 Context of the financial sector

1.2.1 Role of the central bank

The Central Bank, *Banco de la República,* was founded in 1923. Based on the new Constitution of 1991, the Central Bank was restructured as an autonomous and politically independent body with exclusive responsibilities for monetary, foreign exchange and credit policies. The main objective of the Central Bank is to keep the inflation rate low and maintain purchasing power parity. The new constitution made it more difficult for the government to rely on the Central Bank for funding to address fiscal deficits. In addition, it forced the *Banco de la República* to refrain from directly disbursing credit to the private sector. In 1992, the international credit lines for development purposes that were originally administered by the Central Bank were transferred to specialized apex institutions.

[1] All data provided by DANE.

The Board of Directors, which is the main decision-making body, is composed of five members, the General Manager of the Central Bank and the Minister of Finance. In order to increase the stability and independence of the Board, each government can change only two members.

Even after the financial sector reform started in the early 1990s, the minimum reserves were maintained at extraordinarily high levels. The minimum reserve for checking accounts was 41%, compared to 10% in Chile and 15% in Peru (Lora et al. 1993). For savings accounts and time deposits, the minimum reserve rates were 22% and 10% respectively. However, the minimum reserves were lowered and simplified significantly in October 1996. Almost all minimum reserve rates were cut by 50%.

1.2.2 Regulation and supervision

The Superintendency of Banks was founded during the 1930s and restructured and recapitalized in 1989. The Law 45 (1990) and the *Estatuto Orgánico del Sistema Financiero* (Law 1730, 1991) represented milestones in an extensive financial sector reform. The reform measures aimed at introducing international banking standards with respect to accounting principles, minimum capital adequacy, management capabilities and risk management. In addition, the Colombian financial sector was opened to foreign banks and barriers for market entry and the opening of new branches were lowered.

During the last decade, the Superintendency of Banks has strengthened the effectiveness of the control and intervention mechanisms due to the increasing need to control the washing of illegal drug money. The entity receives monthly, quarterly and semi-annual reports from all financial institutions. In addition, it frequently carries out surprise and announced on-site inspections.

Every year, the Superintendency of Banks publishes key data such as performance indicators and balance sheets as well as profit and loss statements for every financial institution and consolidated data for the entire financial sector. These publications increase market transparency and have a positive impact on competition.

Due to the severe financial crisis in the mid-1980s, Law 117 (1985) established a guarantee fund FOGAFIN (*Fondo de Garantías de Instituciones Financieras*) to which all regulated financial institutions are associated. It manages a deposit insurance scheme in order to protect savings below US$10,000. In addition, FOGAFIN intervenes in institutions with solvency problems to avoid bankruptcies, including the provision of capital for institutions with a weak capital base as well as collaboration of the public authorities in liquidating financial institutions. The Superintendency of Banks and FOGAFIN have a close working relationship.

1.2.3 General development and characteristics of the financial sector

The composition of the Colombian financial sector is quite complex and is comprised of a large number of institutional types. In 1995, the formal financial sector was composed of 32 commercial banks, 25 financial corporations, eight savings and housing corporations, 24 commercial finance companies, 35 leasing companies and several other specialized financial institutions such as pension funds and development corporations (Superintendency of Banks 1995).[2] Commercial banks are the most important financial institutions, holding almost 60%

[2] While commercial banks offer a broad array of products, financial corporations are specialized in long term finance for enterprises. The savings and housing corporations operate with long-term mortgage credits to finance

of total assets in the Colombian financial sector. In 1995, the formal financial sector maintained 4,006 branches. The average population per branch ratio was 9,900 and indicates the extensive financial infrastructure of the country.

During the 1990s, a comprehensive financial sector reform was carried out. Apart from restructuring the Central Bank and the Superintendency of Banks, several public financial institutions were privatized. In addition, foreign banks have opened subsidiaries or have participated in national banks. Due to the adoption of prudential regulations, financial institutions strengthened their capital base. Competition in the financial sector has increased in a significant way, contributing to better performance rates, though they still lag behind international standards.

The semi-formal financial sector is comprised by a large number of savings and credit cooperatives and non-governmental organizations (NGOs), which are not regulated and supervised as financial institutions. While the former largely focus on intermediating resources from low-income groups, the latter rely on donor funds and often deliver credit with non-financial services to poorer segments of society. While NGOs cover only some sections of the financial sector, savings and credit cooperatives offer attractive savings facilities and compete very successfully with formal financial institutions.

The informal financial sector shows a large array of different actors including traders, moneylenders, friends and family members, to mention just a few. However, as very little information about informal financial agents is available, it is difficult to estimate their impact.

1.2.4 Outreach and characteristics of state interventions

As a consequence of the extensive reform measures of economic liberalization, direct state intervention has declined in the financial sector. However, the government continued intervening in specific areas when macroeconomic stability was at stake. In order to control capital imports and the respective inflationary pressures in the early 1990s, the government introduced interest rate ceilings again.

In addition, the public sector maintained the former development policies that were directed to support strategic economic sectors. Therefore, all financial institutions are obliged to invest in the Agricultural Finance Fund FINAGRO (*Fondo para el Financiamiento del Sector Agropecuario*), which adds 7% to the minimum reserve requirements.[3] FINAGRO's interest rates are below market and, hence, these investments turn out to be largely unproductive.

Apart from FINAGRO, several other apex institutions exist that channel funds to strategic economic sectors: FEN (*Financiera Energética Nacional*) for the energy sector, BANCOLDEX (*Banco Colombiano de Exportación*) for the export sector, and IFI (*Instituto de Fomento Industrial*) for new private enterprises as well as micro, small and medium businesses. These institutions administer international credit lines for development purposes. They charge market interest rates, however, and the financial institution is free to set the corresponding interest rate for the individual borrower. In this sense, these apex institutions are fully in line with a market-based approach to allocate development funds.

real estate and can only offer savings accounts and time deposits. Commercial finance companies are only allowed to mobilize time deposits in order to provide capital for the commercial and service sectors. Leasing companies represent a special form of commercial finance company.

[3] FINAGRO was founded in 1991 and is a stock corporation with mixed capital. It is a rediscounting facility related to the Ministry of Agriculture. See Ediciones Bancarias y Financieras/Banco Caja Social 1995.

1.2.5 Social security system

In the early 1990s, Colombia underwent a comprehensive reform of the social security system. Private pension funds were established to complement the traditional public pension system. The public social security system includes all employees of the private and public sector. Currently, 4.6 million persons out of a total working population of 15 million are enrolled in public or private pension funds. The eight private pension funds have become quite attractive and attract an equal number of customers as the public system. The large informal sector, which accounts for at least half of the working population, has neither access to the public social security system nor to the private pension funds. Apart from the pension fund system, there is a public health system administered by the Ministry of Health (70% population coverage), the social security system (50%) and a private insurance system (10%).

1.3 Social and socio-cultural context

In 1996, almost 41 million people lived in Colombia and the population density was 35.6 inhabitants per square kilometer. Roughly 70% of the population live in urban areas. The average annual population growth rate reached 2% during 1980-1994.[4] More than one third of the population is younger than 15 years. Colombia has significantly expanded the education system in the last decade and, hence, the illiteracy rate for male and female adults was only 9% in 1994 (World Bank 1996).

The first formal financial institutions go back to the last century. Target-group oriented intermediaries such as the *Banco Caja Social* also have a long tradition. Therefore, the population is familiar with cash and non-cash transactions. In addition, as the current financial infrastructure included smaller towns, the majority of the population gains access to financial institutions to carry out their monetary transactions.

1.4 Classification of the macroeconomic, financial and social context

Colombia shares many similarities with developed countries. First, the service sectors are predominant in the economy as far as the composition of the GDP and of the labor force is concerned. Second, after having experienced years of rapid growth during the 1970s and early 1980s, Colombia is now suffering from macroeconomic instability.

A comprehensive financial sector reform was carried out during the 1990s. The Central Bank and Superintendency of Banks underwent complete restructuring and recapitalization. The legal framework was revised and international banking standards introduced. In addition, the financial sector was opened to foreign investors and the procedures to open new branches were debureaucratized in order to broaden and deepen the financial sector.

A large part of the population lives in urban centers and works in the service or industrial sector. As the first financial institutions date from the last century and the financial infrastructure has always been extensive, the level of monetization as well as of cash and non-cash transactions in Colombia is very high.

[4] All data provided by DANE.

2 INSTITUTIONAL ANALYSIS

2.1 General characteristics of the *Banco Caja Social*

The *Caja de Ahorros del Círculo de Obreros*, which preceded the *Banco Caja Social* (BCS) was founded in Bogotá in 1911 by a Jesuit priest. The *Caja de Ahorros* was only one among several social welfare projects undertaken by the Jesuit community to combat the poverty of the working classes. At the beginning, the *Caja de Ahorros del Círculo de Obreros* operated in the tradition of the European savings banks, which focused on the mobilization of savings. The loan business, which was introduced at a later stage of institutional development, was considered a complementary instrument.

During the 1970s, the Jesuits founded 12 other enterprises in order to provide a greater variety of services to the poor segments of society. These enterprises include a savings and housing association, a leasing firm and an insurance company offering complementary financial services to the bank. In 1984, the *Fundación Social* emerged as the leading agency to coordinate the various social programs and maintain the leadership of the 13 companies. As these firms are partially or totally owned by the foundation, they form together the so-called *Grupo Social* which, however, is not a "holding" in legal or operational terms.

The social projects and the administrative costs of the foundation are entirely financed by the profits earned by the companies. Concerning the *Banco Caja Social*, which is the leading company of the Group, the *Fundación Social* is the exclusive owner and retains roughly 90% of the yearly profit.

Due to new legislation, the former *Caja Social de Ahorros* was forced to transform into a commercial bank in 1991. The name was changed to *Caja Social* at that moment in order to make clear that the variety of services would go beyond savings facilities. However, the word "Bank" was not added to the company's name until 1996 due to the customers' initial fear to work with a commercial bank.

The target clientele of the bank includes:

- Private persons that belong to low- and middle-income class earning up to 20 times the minimum salary (US$172 to US$3,440 per month).
- Micro, small and medium enterprises. *Banco Caja Social* defines microenterprises as those whose annual sales are below US$500,000, while small and medium enterprises have annual sales between US$500,000 and US$6,000,000.

Concerning performance after 1991, *Banco Caja Social* has been facing, and still is facing, the following challenges:

- BCS must fulfill the new legal requirements for commercial banks.
- There has been very strong competition from commercial banks, savings and credit cooperatives and non-governmental organizations (NGOs). Savings and credit cooperatives and NGOs, most notably, have entered the traditional market segment of BCS.
- Formal transformation into a commercial bank was accompanied by a broadening of the variety of products and by an expansion of the target clientele. This requires ongoing efforts to adjust the organizational set-up as well as the internal procedures and corporate identity of BCS.
- BCS has shifted from a forced savings methodology to voluntary savings facilities.

- The demand for credit increases at a more rapid pace than the mobilization of savings.
- Savers have become more and more demanding with respect to the profitability of their savings as well as accessibility and other conditions.

Despite these challenges, the bank is an important actor in the Colombian banking sector. The bank's branch network is currently comprised of 136 branches located throughout the country. The *Banco Caja Social* serves roughly 1.2 million customers with savings and credit facilities. In December 1996, there were 1.2 million savings accounts and 210,000 outstanding loans. Most of the customers have multiple linkages with the bank. In December 1996, the average traditional savings account was US$171 with 71.9% of these accounts showing a balance below US$50. In March 1997, the average outstanding loan was US$2,520.[5]

In December 1996, BCS was the 11th largest of 32 commercial banks in regards to outstanding loan portfolio and total equity and ranked 12th concerning assets holdings of all Colombian banks. With respect to savings accounts, it was the 8th largest bank in Colombia, which corroborates its tradition as a strong savings institution (Superintendency of Banks 1995). In addition, BCS ranks among the top 12 Colombian banks with regard to profitability. However, especially in the area of savings mobilization and profits, BCS has not performed as well as in other areas, where their pace of expansion is similar to that of other commercial banks. At the end of 1994, BCS held the 5th largest volume of savings accounts in the banking sector. At the same time, their return on equity was 32.5%, but it dropped to 19.0% two years later.

2.2 Institutional type, governance and organizational structure

2.2.1 Institutional type and governance

The *Caja de Ahorros del Círculo Obrero* was registered and legally recognized as a non-profit financial institution in 1931. In 1990, the financial system reform included the abolishment of this institutional type of savings banks. Therefore, the *Caja* became a private, full-fledged commercial bank (non-stock corporation) in 1991. Because the *Fundación Social* is the exclusive owner of the *Banco Caja Social* and is an organization of public interest, BCS is considered a non-profit institution. This exceptional status is clearly stated in the governing statutes of the bank and, therefore, BCS is exempted from paying corporate tax.

The main governing bodies that define the policies of the bank are the Board of Administration, the Board of Directors and the President.

The Board of Administration is integrated by the members of the Board of Directors of the *Fundación Social*, which is the exclusive owner of the bank. It includes seven members who are professionals and businessmen supporting the foundation with experience in financial and business affairs. Every year, only two out of the seven directors are appointed, with the possibility to be re-appointed, in order to ensure maximum stability through personal continuity. The directors are remunerated and meet at least once every six months. Decisions are made by simple majority except when by law, or specific statute arrangements, a special majority is required (e.g., dissolution of the bank).

The functions of the Board of Administration include all strategic decisions of BCS including personnel decisions such as the appointment of the members of the Board of Directors and

[5] This figure includes large credits to other companies of the Group.

of the permanent auditor (*Revisoría Fiscal*, see section 2.5.2). In addition, it determines the increase of capital and the utilization of profits, approves the financial statements submitted by the Board of Directors, interprets the statutes and decides over modifications of the statutes and the dissolution of the bank.

The Board of Directors is comprised of five members - all of them private businessmen or people with experience in finance – who are appointed by the Board of Administration for a one-year period. All directors are appointed on March 31 of each year, but can be re-appointed. It is not allowed that two or more persons with family ties form part of the Board at the same time. During tenure of office and the first six months after having left the Board, a Director is not allowed to establish a contractual relationship with the bank (except to obtain a loan). The President, the *Revisor Fiscal* of the bank and the Social Director of the *Fundación Social* attend the meetings of the Board, but do not have voting power. The Directors, but not the persons without the right to vote, get paid for every meeting they attend. There are monthly meetings, which can be complemented by extraordinary meetings. Decisions are made by absolute majority.

The responsibilities of the Board of Directors include the appointment of the President and the respective senior managers at the national and regional level, the definition of the internal regulatory framework of the bank, the operational guidelines and policies for asset and liability management. In addition, the Directors are responsible for the organizational structure of BCS, authorizing the opening of new branches and agencies, creating committees, and deciding upon new staff positions. They also fulfill administrative tasks such as the presentation of the financial statements and other documents, a proposal for the distribution of earnings to the Board of Administration, overseeing and examining the books and other documents of the bank and the approval or disapproval of credit applications from bank staff.

The President is the major executing body and legal representative of the bank. The Board of Directors appoints the President for a period of one year, but with the possibility of re-appointment.

Despite the fact that the Board of Administration formally operates outside the bank, it is the most powerful body and has an extraordinary impact on the policies of the bank. Hence, the *Fundación Social*, as the exclusive owner of BCS, directly assumes the ownership and control of the bank. The Board of Directors shows characteristics of a consultative group and intermediary between BCS and the foundation.

In this context, it is also important to consider that the current President and *Revisor Fiscal* held important positions in other companies of the *Grupo Social* in the past. Therefore, the *Banco Caja Social* is connected to a wider top-level management rotation system within the Group. This contributes to ensure that the senior management is committed to the vision and corporate identity of the *Fundación Social* and the Group.

With respect to the primary capital of the bank, it expanded rapidly during the 1990s. The paid-in capital reached almost US$48 million in December 1996 compared to US$8.3 million in 1990. Due to high capital reserves and surplus, total equity has been twice as high as paid-in capital during the last few years.

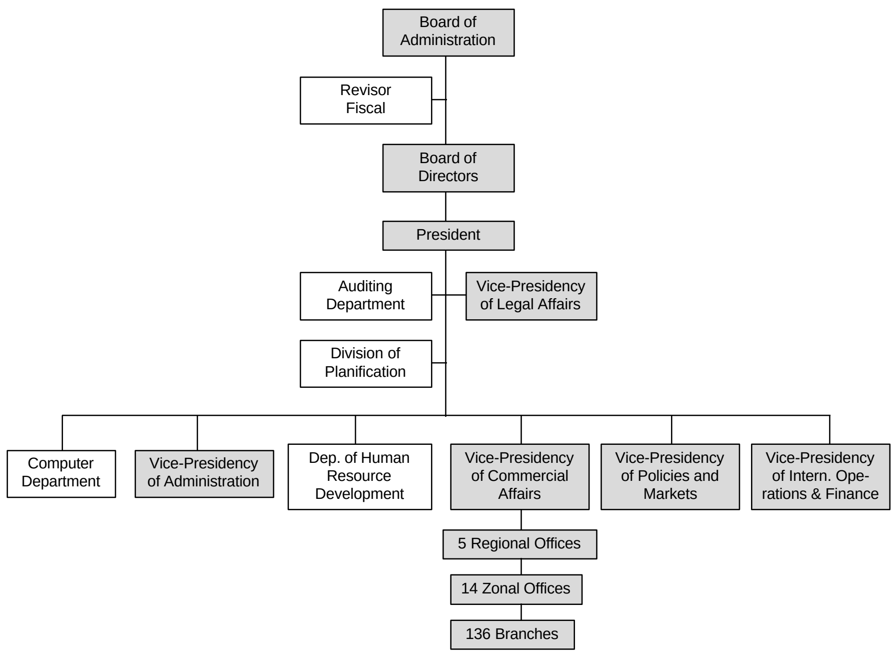
2.2.2 Organizational structure

The organizational structure of the bank is currently under review. The following modifications are considered:

- Shifting towards a market segment-oriented organizational structure;
- Creating a new microenterprise center within the bank to target this market segment in a more effective and efficient way;
- Separating areas related to defining bank policies from those executing these policies; and,
- Redistributing responsibilities in order to reduce the control span of each functional area.

The following diagram presents the proposal for the modified organizational structure of the bank as it will be implemented in the coming months.

Graph 1: Organigram of *Banco Caja Social*



With respect to savings, the Vice-Presidency of Commercial Affairs[6] currently contains a special division that designs new savings products and is responsible for the respective marketing strategies. However, with the new organizational structure, each division of the Vice-Presidency of Policies and Markets will be responsible for one market segment (individuals, microentrepreneurs or small and medium enterprises) and develop and commercialize savings and credit products. Hence, the former centralized focus on savings will be replaced by an integrated approach.

With respect to operational structure, the bank relies on 18 different committees for decision-making in specific areas. The Committee of the President is the most important forum and is comprised of the President and all Vice-Presidents. Weekly meetings are held where the business plan for the bank is developed and current problems in the different

[6] The current Vice-Presidency of Commercial Affairs will be split in two Vice-Presidencies in mid-1997. The Marketing Division will then be transferred to the new Vice-Presidency of Policies and Markets and carry out marketing services for both savings and credit products.

areas are discussed and decided. In this sense, the President and the top-level managers exercise a cooperative leadership. In addition, six different credit committees on the national, regional, zonal and local levels exist with different levels of responsibility in terms of maximum credit amounts that can be approved. The other committees are oriented towards the solution of problems in specific technical areas such as purchase of goods, standards of bookkeeping and internal audits, marketing and public relations, etc.

Despite the extended branch structure, BCS has only partially decentralized decision-making powers and administrative control. The headquarters in Bogotá develop the general business plan for the bank in all functional areas and set the respective commercial targets for all branches. Headquarters define new financial products and technologies and take care of administrative as well as control tasks.

In the commercial area, the bank structure is comprised of three different levels:[7] 136 branches or agencies, 14 zonal offices, and five regional offices.

A typical branch is a simply-structured unit with 10-15 staff members. Each branch or agency is a profit-center within the bank and must fulfill its business goals. The branch philosophy focuses on the customer, introducing a new service culture. High levels of service quality characterize each branch. The products as well as the services and the branch characteristics are standardized. The branch staff minimizes all administrative operations and focuses on the direct communication with the customer. In addition, financial advisers are intended to be able to satisfy all of the financial needs of the customer.

The zonal offices can be considered as a small support unit to the branches and agencies and are composed of 7-8 persons. The orientation of the zonal office is almost exclusively commercial. Each zonal office attends 6-14 branches with an average of 10. The focus of the zonal office is to send specialized loan officers to the branches that have accumulated considerable arrears.

The structure of the regional offices is much more complex as they combine commercial with administrative and monitoring functions. Each regional office has approximately 40-50 employees. At the regional level, the various functional areas are quite similar to those at headquarters. There are coordinators for human resource development and personnel, administration, control, etc., as well as a legal adviser. The zonal manager fulfills a crucial function as he links headquarters with 18-36 branches, channeling data and information in both ways.

In addition, four different service centers are linked to the regional office:

- The Credit Center assessing all the credit applications submitted by the branches in the region;
- The Clearing Center calculating the daily balance of cash and non-cash transactions of the branches,
- The Computer Center; and
- The Accounting Center.

Within the decentralized branch-office network, a hierarchy for credit approvals exists based on the loan amounts requested. The maximum loan amount that can be exclusively approved by the branch managers range between US$3,000-20,000 with an average of

[7] As of December 1996.

US$10,000. Zonal managers can approve loan applications that do not exceed US$30,000-40,000, and regional managers can approve applications up to US$60,000. Applications with higher loan amounts must be presented to the respective credit committees.

Branches and regional offices run their own semi-decentralized computer-based data system. An on-line electronic communication network between the branches does not yet exist, so information is exchanged by fax, hardcopy or floppy disc. Each branch computer system automatically elaborates a certain number of daily reports such as lists about loans in arrears, liquidity position, clearing reports, etc.

The number of staff per branch and office is quite high compared to the Colombian banking system. In October 1996, the ratio between staff expenses and total assets was 11.3% for BCS, while the same indicator for the Colombian banking sector showed only 8.1%. In addition, BCS experienced a considerable decline of savings accounts per employee from 542 in 1994 to 463 in 1996, while the total amount of deposits per staff increased slightly from US$175,200 to US$175,700 during the same period.

2.2.3 Lessons learned in institutional type, governance and organizational structure

2.2.3.1 Success factors

BCS shows a long tradition in savings mobilization with the bank's corporate identity always having been based on small savings. The original name of the bank also emphasized the special focus on savings. Though the financial sector has passed through critical moments and several banks had to be closed down in the past, BCS and its preceding institutions have never shown severe liquidity or solvency problems. The commitment to small savers and the good performance of the bank over the years contributed to building trust among savers.

The foundation exercises strong ownership of the bank and is involved in all strategic decisions. It ensures that sound and efficient financial operations take place and that the social orientation towards poorer segments of society remains constant.

The bank has a specialized division for the design and marketing of savings products. For each savings product, there is a special product manager who is in charge of reviewing and improving the performance of the product.

The branch network is very extensive and the branches are located close to business centers in order to facilitate access to the bank. In addition, the branches focus almost exclusively on direct contact with the customer, which demonstrates a strong service orientation. The branches operate with a minimum physical infrastructure to cut costs. However, they are fully computerized in order to speed up financial transactions and maintain control.

Branches are designed as independent accounting and financial entities and act as profit centers. However, they have access to secondary support structures within the bank that provide special services (e.g. uniform marketing material, auditing services, clearing, etc.) which are charged to each branch.

2.2.3.2 Limitations and risks

Due to the transformation into a commercial bank, BCS has redefined its corporate identity as a full-fledged financial service institution. In this sense, there is a shift from savings towards additional financial services and new market segments. Not all customers have welcomed this change as they fear working with a commercial bank. In addition, the internal reorganization and redefinition of a "service culture" may lead to a stronger focus on new products and market segments than on the traditional savings products and small savers.

The reorganization of BCS crucially depends on the quality and capabilities of staff.

Within branches, the cashiering section generally accounts for much less personnel than the financial advisory section. Therefore, in some branches, there are long waiting lines during peak hours at the teller counters, which seems to be counter to the new "service culture". Especially for small savers, the respective transaction costs may discourage savings.

Control is maintained at a high level of the institution, which makes it difficult, to ensure the full enforcement of internal regulations and a strong corporate identity at all levels. This may make it difficult to standardize high service quality and a coherent branch presentation, which, hence, may undermine the confidence of savers.

Due to the semi-decentralized data system, which is not electronically connected, the flow of information is slow because several intermediaries participate. In addition, the risk of generating inconsistent information exists. Finally, each level or division within the bank only has access to a limited part of the total information collected for each customer. Therefore, the bank might face limitations in reviewing and improving the performance of the savings products.

BCS has experienced high personnel expenses and a decrease of operational efficiency during the last three years. The average volume of savings per BCS employee in 1996, for example, was 28% less than for the Colombian banking sector.

2.2.3.3 Possibilities of replication

BCS shows some unique characteristics, such as strong ownership by the foundation and a long tradition as a savings institution, which cannot be easily replicated by other institutions. However, some interesting insights can be gained from BCS' transformation into a commercial bank. Though compliance with the strict legal framework for commercial banks contributed to improving performance, some traditional customer groups feel uneasy with the bank's new corporate identity. In addition, the bank has shifted towards new financial products and market segments that may undermine the original orientation towards savings.

2.3 Demand-oriented savings products and technologies

2.3.1 Characteristics of demand-oriented savings products and savings technologies

In the past, BCS offered only two simple products: traditional savings accounts, and time deposits. The savers could voluntarily deposit money or link savings to credit. However, the savings products were largely designed as an entry ticket to credit and based on the principle of reciprocity. This implied that the customers first had to save 20-25% of the credit amount. In addition, the term structure of the loans depended on the maturity of the savings.

Due to severe market pressures and legal changes, BCS introduced voluntary savings products in 1994. In addition, the variety of savings products has broadened considerably in order to respond to the specific requirements and savings motives of various market segments. The products currently offered include:

- Checking accounts;

- Traditional savings accounts (passbook savings);
- "Grow Every Day" savings account (*Subediario*);
- "Everyday" semi-liquid savings accounts with fixed terms (*díadía*);
- Time deposits (CDTs).

The bank will introduce a new savings account, *MEGACuenta* ("MEGAAccount"), during the first half of 1997. The objective of *MEGACuenta* is to introduce savings to youth so that savings become an integral component of life at an early stage. In addition, children can become familiar with BCS and establish a permanent relationship with the bank that endures.

The key factors of success of BCS' savings products include the following:

- The current product names are memorable and almost self-explanatory. In addition, each product has its own trademark or product symbol, which is always used in public advertisements and product leaflets. Both factors help savers recognize the product and identify themselves with the product.[8]
- The savings products offer a large array and combination of terms including remuneration, minimum opening balance, minimum balance to receive interest payment, commissions, tax payment (VAT) and access to additional incentives (lotteries, debit cards, credit cards, etc.).
- There are liquid and semi-liquid savings accounts as well as time deposits with fixed terms and without possibilities to withdraw.
- The effective interest rates are close to market rates in the banking sector. However, savings and credit cooperatives, which have increased their presence in the traditional market segments of BCS, offer even more attractive interest rates.
- The interest rates vary according to the savings balance or term structure. No interest is paid for a balance below a minimum amount.
- In some cases, interest accrues on a daily basis. In the case of the traditional savings account, interest is compounded on the minimum balance each quarter.
- The minimum opening balances are relatively low and allow low-income groups to gain access to the savings facilities. In the case of a traditional savings account, the minimum opening balance is less than one third of a monthly minimum salary.
- There is an unlimited number of withdrawals or deposits except for time deposits.
- According to the savings product, BCS charges commissions for different financial services such as the passbook, the issuance and operation of a debit card, the use of an ATM that does not belong to the bank, etc.
- The savings accounts include a debit card and a credit card facility for selected customers. This makes access to the savings account even more convenient as the customer can use the 89 ATMs of the bank and the three largest ATM-networks in the country.
- Depositors participate automatically in lotteries held quarterly. For each US$100 deposited in the savings account, the saver obtains one lottery ticket. The prizes include cars, electronic equipment, furniture, etc., and are exhibited in the service hall of the

[8] In comparison, the bank used several abbreviations (e.g. CDT, DAT) for the savings products in the past. This made it difficult for the customer to distinguish the products and to decide which savings facility best suited their needs.

branches. There are only three other banks in Colombia that offer lotteries to attract savers.[9] At the "International Day of Savings," the bank holds a special lottery with more valuable prizes (e.g., cars).

2.3.2 Design of demand-oriented savings products

The bank always carries out market studies before new products are introduced. The Marketing Division is in charge of designing the tailor-made outline of the market study and contacting and selecting the consulting firm that finally carries out the study. Depending on the complexity of the new product and the market segment to be targeted, the development of the product can take a couple of weeks (e.g., checking account) or several years (e.g., *MEGACuenta*).

The Marketing Division maintains a database of consulting firms with various profiles. When a study needs to be carried out, the bank normally invites three consulting firms to present a detailed proposal. The proposal with the best cost-benefit ratio is selected.

When a very complex and risky savings product needs to be tested, several market studies are carried out. The first study tests the general market potential by a random customer survey. The second study focuses on the financial and operational effects of the new product after pilot tests with a small customer sample in the field. Finally, similar products of competing financial institutions are examined in order to define the strategic comparative advantages of the new BCS product.

Presently, the resources for carrying out market studies are limited. Market studies absorb less than 5% of the funds reserved for public relations, which accounted for less than 5% of total operational expenses in 1996. The bank will spend roughly US$0.15 per customer for market studies in 1997. Therefore, BCS has to very carefully select the market studies they will carry out.

Apart from these product-oriented market studies, the bank continuously observes competing institutions. The objective is not only to be prepared for a rapid change of conditions such as interest rates. BCS also obtains ideas for new, potential financial products and technologies and reduces its own investigation and product development costs.

2.3.3 Procedures to introduce demand-oriented savings products

After having determined the design of a new savings product, the Marketing Division defines a promotion strategy, including the logo, passbook design, posters, radio and television ads as well as other marketing mechanisms. Depending on the market segment that will be targeted, the bank might sponsor events (e.g. in the case of the *MEGACuenta* of some youth festivals).

The Division of Human Resource Development together with the Marketing Division prepares the respective training courses for branch staff.

In order to test the receptivity of different local markets and operational procedures (e.g., new software), all branches are involved in a final test before launching the new product officially.

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[9] Lotteries are an important instrument to attract savings. The branches distribute leaflets and put up special ads to inform the customers about the next quarterly lottery. In the past, the lotteries took place in public. However, the costs were too high and the participation was disappointing as most of the customers worked during the day and could not attend the drawing party. Now, the lotteries are transmitted on television and the winners are informed by mail.

Commercial targets are set for each branch, forcing the staff to become familiar with the new savings product and to accept it as their new product. All potential problems must be solved before the new savings product will be marketed on a wide-scale basis.

2.3.4 Lessons learned in the design and handling of demand-oriented savings products and technologies

2.3.4.1 Success factors

The savings products respond to different savings motives and market segment characteristics, providing a mix of return, level of liquidity, opening balances, administrative costs, etc. Each product has its own design, catchy name and trade mark and can be easily recognized by the customers.

When the savings accounts are combined with debit cards, the savers can easily gain access to the account. This feature is even more important because it allows clients to debit money from the bank's ATMs as well as several other providers of ATM services through a nation-wide network.

The quarterly held lotteries are popular among savers. The prizes are presented as eye-catchers in larger branches. In addition, BCS actively promotes the lotteries through leaflets and banners.

BCS relies on market studies before introducing new savings products to the wider public. In general, deskwork market studies are combined with empirical tests with a limited random sample. In addition, BCS closely observes the market research carried out by competing financial institutions.

A comprehensive work plan is elaborated to prepare the official start of a new savings product. The promotional strategy is defined, training measures are carried out and a final empirical test with the participation of all branches is conducted to prepare the ground for scale operations.

2.3.4.2 Limitations and risks

The shift from a forced to a voluntary savings model is still not fully reflected in the practical, daily work of branch staff. Some branches are still reluctant to sell voluntary savings products and prefer to offer a credit plus savings package. To some degree, this is due to the long tradition of using forced savings as an entry ticket for credit, based on the principle of mutual reciprocity. In addition, the current monitoring system is not capable of screening out savings that are enforced by moral suasion.

In addition, the commissions and fees that BCS charges to each savings account can turn out to be prohibitively high and discourage small savers from opening an account with BCS.

The budget for market studies is very restricted and does not allow for broad testing of new, risky products such as the *MEGACuenta*. Due to limited research funds, the development of new savings facilities may take a longer time than necessary. Therefore, it is difficult to maintain the institutional memory in order to keep track of the project. In addition, other financial institutions might beat BCS to a similar savings product or technology in the meantime.

2.3.4.3 Possibilities of replication

The success factors can be easily introduced in other financial institutions. However, as BCS shows, the good design of savings products and appropriate incentive schemes (e.g. lotteries, debit cards) is not sufficient if the bank staff has not freed itself from the tradition of forced savings.

2.4 Management capabilities

2.4.1 General management capabilities

2.4.1.1 Human resource management

At the end of 1996, the *Banco Caja Social* had 2,727 employees. As the salaries in insurance and leasing companies are generally higher than in other institutions of the financial sector, men are less attracted to employment in the banking sector. In BCS, the participation of women is quite high (57% of staff). The participation of women in senior management positions should be highlighted. Apart from the President, who is a woman, 61.5% of the branch managers as well as mangers of the zonal and regional offices are female. Salary payment does not discriminate between men and women. Though a specific career promotion strategy does not exist for female employees, as the above-mentioned figures indicate, women have good opportunities to advance to positions of mid-level and top-level management. The average bank employee is 29 years old and has worked for the bank for 4.2 years. Hence, young staff is expected to be flexible in adapting to new products and technologies and to be motivated to learn.

The staff recruitment procedures strongly emphasize the non-technical capabilities of the candidates such as their communication skills, motivation and capability to work in a team. BCS hires specialized companies to carry out personality tests. Negative results in the personality test cannot be compensated by good grades or strong technical skills. For BCS, it is very important to have personnel that can be easily integrated into the bank's team and that is capable of gaining the trust of the customers, especially of the savers.

New branch staff generally begin as junior tellers before being promoted to senior tellers and eventually advancing to financial advisers. Except for branch managers, who are generally recruited from outside the bank, the staff is promoted within the same branch. This branch career pattern facilitates the development of permanent relations with the customers; especially important to gain the confidence of savers.

The *Banco Caja Social* introduced a service culture concept called the "customer-oriented office." Branch staff is supposed to behave as a "financial friend" and establish a permanent, trusting relationship with customers. Financial advisers have replaced specialized savings and loan officers and are supposed to be able to address all of the financial needs of the customers in an integrated approach.

The bank has designed a mascot called "financial friend" that transmits the corporate image of BCS. The mascot represents a teller or financial adviser who is a well-dressed person with a tie but without a suit.[10] He has rolled-up sleeves as if he is entirely dedicated to serve his customers. In addition, he shows a big friendly smile to gain the confidence of the

[10] A female version of the financial friend does not exist, though a large proportion of the staff, including the tellers and financial advisers who directly communicate with customers, are women. However, the majority of the customers are men.

customers.[11] This mascot is very popular and symbolizes in a very concrete way the logo of the bank: "*Banco Caja Social* - your friendly bank." The mascot is exclusively used for the promotion of savings products.

A very complex bonus system exists, which is based on a monthly competition between branches and offices in the country. Every six months, the best national branch is determined by the accumulated monthly results. The national branch with the highest level of compliance with the commercial goals wins the monthly or semi-annual bonus, which is shared by all branch team members. The scoring system includes nine different target indicators. The indicators that are related to savings mobilization represent 55% of the total score, compared to 33% related to the credit business and 12% for the branch utility. Hence, the bonus largely depends on good performance in savings mobilization. Other competitions take place sporadically such as "best teller" and "best financial advisor." The performance bonuses can make up to 50% of the regular monthly salary.

The winners of the semi-annual competition are invited to a large event. The winning teams from all the local, zonal and regional offices come together in one of the larger cities of the country. Top-level managers from headquarters, including representatives from the *Fundación Social,* participate in the event.

Banco Caja Social is now testing a new complementary incentive system based on quality indicators to assess the service culture of each branch. A panel comprised of ten randomly selected customers will evaluate the branches. The panel will meet each two months to assess the performance of the branch in five qualitative categories. The most customer-oriented branch will obtain a performance bonus.

In the near future, a bonus system for senior managers in headquarters will be introduced based on the fulfillment of objectives. If this system is implemented successfully, it will be expanded to the entire administrative staff of headquarters.

Training measures have become increasingly important for BCS since its transformation into a bank. In 1991, a special Training Division was created. In addition, each of the 14 zones has a training center. The total training budget for 1996, including special projects, represented approximately 9% of the total personnel costs for the year. In the same year, BCS spent an average of US$840 for every staff member for training, which is more than one average monthly salary for a financial adviser.

Two long-term experts financed by German Technical Cooperation (GTZ) support the Department of Human Resource Development. The main activities of these experts include the design of dual training methods, the improvement of basic bank training, further development of the internal communication system, and the design of special microcredit technology that is appropriate for microentrepreneurs. Finally, these advisors facilitate an exchange of experience between German savings banks and BCS.

Comprehensive training measures include in-house training as well as access to external training facilities. There is a regular internal training program with 43 courses that transmits basic banking skills but increasingly focuses on service-culture concepts and marketing strategies. Specialized training courses for savings do not exist, except for the introduction of new savings products. In addition, there are tailor-made training courses that respond to the

[11] In the past, the appearance of the financial friend was more working-class oriented, but has been changed to resemble more to a traditional banker. This was the result of the change of image from a traditional savings banks to a modern, full-fledged commercial bank also targeting new market segments with higher economic potential.

specific needs of a division or branch. The internal branch career is based on on-the-job-training for superior duties. Finally, dual training courses combine theoretical and practical training on the job. The majority of the training courses are short-term. However, they take place frequently and everybody in the bank receives specific training at least twice a year.

2.4.1.2 Management information system

The following aspects characterize the Management Information System (MIS):

- The MIS has undeliberately mushroomed with the growth of the bank and the more complex organizational structure. Hence, a comprehensive design for the MIS does not currently exist.
- The decision-making power is centralized in headquarters. Therefore, all information flows are oriented towards the Vice-Presidents who, however, have a limited capacity to process all the data.
- Every department or division decides what kind of periodic data they should prepare and who should receive the data. As a consequence, there are multiple sources providing similar information.
- There are a large number of internal communication papers. This large quantity of information makes it difficult for staff to keep informed about what is relevant.
- The bank operates a semi-decentralized data system that is not electronically connected. Therefore, a consolidated comprehensive customer database does not exist. Computer capacity is restricted. In some cases, it is only possible to calculate data for a particular moment or area without being able to aggregate or cross-check data from different branches.
- Much more detailed information about the performance of the savings products exists than for loan products.

In order to improve the computer system for the entire Group, the *Fundación Social* has initiated a "Global Project of Change". The foundation will invest US$20 million to implement a comprehensive computer program within a three year period. By February 1999, the new system should be installed in the first branch.

It is evident that BCS must develop a coherent MIS in order to remain informed about all situations that could require quick intervention. In addition, it is a sine qua non for strategic planning such as the development of new financial products for specific market segments.

2.4.1.3 Institutional learning mechanisms

Some major institutional learning mechanisms, especially those focusing on the commercial areas of BCS, largely relate to customer assessment. Twice a year, the Marketing Division purchases a market study on consumer perception of the Colombian financial sector. BCS will also soon introduce customer panels to assess the service quality of the branch network on a permanent basis (see section 2.4.1.1). In addition, special studies are carried out to address critical issues, e.g., the introduction of new products or the increasing number of inactive savings accounts.

With respect to the review of internal procedures and organizational features, BCS presents a varied picture of institutional learning. The foundation participates in the examination of crucial aspects of selected functional areas (e.g., computer systems). In addition, several divisions periodically review their activities (e.g., a yearly review of the bonus system). In this sense, BCS does not have a systematic approach to institutional learning that integrates *all* institutional levels.

2.4.2 Special management capabilities: Risk management

The risk management of BCS does not only consider measures to protect the physical security of funds, but also includes risk-adverse asset management. The latter is important to ensure that savings are invested in activities that bear a low loss risk and that, hence, the recovery of savings is secure.

2.4.2.1 Physical security of savings

BCS applies high security standards in order to protect savings. In each branch there is at least one armed guard in uniform who is sometimes accompanied by a watchdog. In some branches, the guards have a special booth where they can watch the customers and cannot be attacked. In 20 branches, BCS has installed cameras. Money transports are carried out by specialized firms and armored transporters. Each branch has its own safe, which can only be opened in the presence of two persons, administering the codes, and a 30-minute waiting time after the codes have been entered into the system. One third of the branches is equipped with special safes that can only be opened during regular office hours.

2.4.2.2 Risk management in credit operations

A couple of years ago, the Superintendency of Banks observed the loan procedures of BCS and suggested the bank to introduce major changes. This experience, together with the fact that the outstanding loans represent the largest proportion of the bank's assets (72.7% in December 1996), leads the bank to pay a great deal of attention to the risk management of credit operations.

The loan portfolio is very diversified. The largest proportion of the outstanding loans is held by employees with a regular monthly salary from which credit installments can automatically be deducted. Credit operations never reach the strict credit limits defined by the Superintendency of Banks in order to reduce risk concentration (see section 2.5.1).

The minimum professional experience of each potential borrower running his own enterprise must be one year. New entrepreneurs are excluded from credit services. Employees must be employed for a minimum period of six months. Persons older than 69 years, who apply for a loan the first time, are automatically excluded because BCS believes they present higher credit loss risks.

In the credit cycle there is a strict separation between assessing the credit application and approving or disapproving it. Seven regional Credit Centers are specialized in analyzing credit applications and suggesting whether a loan should be approved or not. However, the final decision is made by the branch manager or the credit committee if higher loan amounts are at stake.

Credit assessment relies on multiple sources of information and methodologies of evaluation.[12] The main objective is to distill reliable data by cross-checking different sources.

[12] The major sources of information and assessment methodologies include, apart from data obtained by the potential borrower and the recommendation of the branch, (a) the credit and savings history with the bank, (b) telephone contacts with references of the potential borrower, (c) visits to the applicant at home or at the work place, (d) information from two national credit information centers, (e) information from fiscal authorities in the case of registered companies, and (f) sector reports of the Central Bank.

In this context, BCS also reviews the savings history of the borrower in order to obtain an idea about the trustworthiness and the economic potential of the customer. The assessment of the loan application is fully computerized, including the automatic calculation of ratios. The credit recommendation of the Credit Center that is presented to the retail outlet or credit committee is always based on the joint examination of the credit analyst and the coordinator.

When the potential customer is a micro, small or medium entrepreneur, a specific risk classification system is applied combining quantitative and qualitative data. It is a very complex scoring system that tries to link 15 factors. In order to obtain a positive result in the credit assessment, a loan applicant must obtain a minimum score of 70 points out of 100. However, if some key categories, such as payment capacity or level of liquidity fail in spite of an overall positive result, the credit analyst is supposed to present a negative recommendation.

The staff of the regional Credit Centers is very qualified. Credit analysts have a minimum professional experience in credit assessment of at least five years. When they start working at the Credit Center, they participate in an eight-day training-course to become familiar with the special credit technology of the bank. Finally, the staff is trained periodically on subjects such as how to identify falsified documents or how to evaluate balance sheet ratios.

Staff is specialized in assessing high loan amounts, microentrepreneurs and also small and medium enterprises and loan applications from within the *Grupo Social*.

Monitoring of the loan portfolio is decentralized and is the responsibility of the branches. Every financial adviser is in charge of administering his/her own loan portfolio from the loan application to the repayment of the loan. The computer system of the retail outlets prints out daily lists that state new and old credit operations in arrears for each financial adviser. Every 3, 10, 25, 40 and 55 days, the system automatically issues a reminder for the customer with an overdue repayment. Specialized staff in the zonal offices supports the recovery process. If a subnormal loan is not normalized within 90 days, the loan is turned over to an external lawyer. The credit operation will then be prepared for extrajudicial settlement. When a credit is in arrears for more than 120 days, the credit obligation is enforced by legal means.

BCS charges an effective penalty interest rate of 60.945% p.a. on all loans with overdue repayments. This is roughly 15% superior to the regular interest rate and represents the maximum penalty interest rate that is legally permitted.

There are very strict rules for the restructuring of loans to avoid having critical loans transformed into regularly operating loans, which lowers quality of the outstanding portfolio. The credit committees are the only entity that can decide to restructure loans in arrears.

The bank's provision policies follow the norms of the Superintendency of Banks, which largely adhere to the international standards of the Agreement of Basle.[13] However, BCS records arrears only after 30 days, rather than immediately. This policy is in accordance with Colombian laws, though not in accordance with international standards. In addition, given their arrears and default rates as published in the Annual Report of the Superintendency of Banks, provisioning covers the loan losses, but is remarkably lower than the arrears rate.

[13] There are five different loan categories ranging from normal loans to lost loans which are provisioned at 0-100%.

2.4.2.3 Risk of fluctuating interest rates

BCS is exposed to a high risk with regard to the high fluctuation of interest rates. Credit operations show an average term of three years with fixed interest rates while almost 75% of total savings are liquid with variable interest rates. This specific risk has become more alarming as the severe competition in the financial sector has produced an increase in savings interest rates.

This structural problem is wide-spread in the Colombian financial sector. Therefore, the Superintendency of Banks introduced a new regulation on the management of assets and liabilities (*Gestión de Activos y Pasivos* - GAP) in January 1996. It is very likely that BCS will increase provisions significantly in order to cover the risk of fluctuating interest rates.

2.4.2.4 Capital adequacy

According to the Statute of the Financial Sector applied by the Superintendency of Banks, the minimum risk adjusted capital ratio is 9%. Actually, BCS has a capital ratio of 13.2% (December 1996). However, due to supposedly high investment costs in software and hardware and the effects of the GAP on the provision policy, the capital ratio will probably continue to fall as it has in the past few years. This will limit the bank's margin to adopt a more aggressive marketing strategy.

2.4.3 Special management capabilities: Liquidity management

Banco Caja Social has become more and more sophisticated in the area of liquidity management in the last couple of years. First, this is a result of increasing market pressures and the change of BCS' liability structure towards savings with higher financial costs. Second, the bank shifted from forced to voluntary savings facilities some years ago, which made liquidity planning more difficult. Third, BCS permanently needs more liquidity to meet the demand for loans than it can currently mobilize through voluntary savings. Finally, the introduction of the new GAP regulation of the Superintendency of Banks, which includes an evaluation of the liquidity risk, has increased the awareness of bank staff about liquidity management.

Considering the structure and characteristics of BCS' savings facilities, the following aspects should be highlighted:

- The bank relies heavily on deposits. In 1996, 87.4% of the liabilities were comprised of deposits. Only 3.3% of the liabilities were loans from banks or other financial institutions in the same year. These interbank borrowings are at call or have agreed maturity. Due to severe liquidity shortages in 1995, the bank started issuing bonds, which now represent 5.7% of total liabilities. These negotiable bonds were primarily purchased by national pension funds and insurance companies.
- The composition of deposits has experienced some fundamental changes. There are two opposite tendencies: One group of customers increasingly prefers liquid savings that are accessible immediately, while another group shifts slightly from traditional savings accounts to more profitable time deposits. At the moment, the first tendency is stronger than the second.[14]

[14] While savings accounts represented 75% of total deposits (including checking accounts) in 1993, they only account for 60% of total savings at the end of 1996. In comparison, during the same period the proportion of checking accounts has increased from 4% to 13.5% and time deposits have slightly expanded from 21% to 25% of total deposits.

- Savers have become increasingly sensitive to the profitability of different savings products as strong competition in the financial sector to attract savings has increased. Traditional savings accounts show a permanent decline in terms of numbers and volume.
- The bank has a very large number of small savings accounts. This structure of deposits reduces the risk exposure to few, larger savers.[15]
- The turnover of the various savings products is quite low.[16] Roughly 60% of the savings accounts did not show any transactions during 1996.[17] These dormant accounts represent approximately 20% of total savings and provide secure liquidity.
- Considering the various types of savings products, almost 80% of the total volume of savings permanently remains in the bank despite formally short maturities. Even in the case of short-term time deposits, a large proportion is automatically renewed.

The funding policy defined by the Department of Finance strongly relies on savings. As shown above, the bonus system emphasizes the growth of savings with low financial costs. In early 1997, the average financial costs of total savings were roughly 17% compared to 28% interest that the bank pays for the bonds and interbank operations. This considerable interest gap explains why the Department of Finance encourages the mobilization of savings.

An internal liquidity compensation mechanism between branches with excess liquidity and those with liquidity shortages has been established with considerable success. Every day, the internal bank clearing system determines the liquidity balance of each branch. Branches with a liquidity deficit can internally borrow money at 27.3% and the branches with excess liquidity obtain 26.1% for lending funds (as of January 1997). The branches with liquidity shortage are, hence, charged an interest rate quite close to the average interbank rate. This is a strong incentive for the branches to mobilize savings from customers instead of relying on liquidity mobilized by other branches.

Liquidity management is centralized in the Department of Finance. As the Colombian financial sector is mainly short-term oriented, the computer-based liquidity planning model includes only a one-year period. Liquidity projections are based on the commercial targets defined in each branch's business plan. Cash-flow projections are made on a monthly, weekly and daily basis and are adjusted according to actual payments or expenses. The bank uses simple, but very effective EXCEL spreadsheets in order to project the bank's cash flow. Major decisions about interbank operations are made on a weekly basis.

The cash flow projections for 1997, without considering new interbank operations or new bonds, show a permanent deficit. The bank suggests that traditional savings will further decrease and that the estimated loss will not be compensated for by new savings products and a slight increase in time deposits. Hence, BCS will further rely on the money market and increasingly use to interbank transactions.

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[15] Only 0.2% of these savers show deposits above US$10,000 accounting for 19.4% of total savings.

[16] The average number of yearly transactions is 8.99 for each actively-used checking account and 1.44 for each traditional savings account that has had any turnover during the year.

[17] In 1996, the bank carried out a study to find out why the holders of dormant savings accounts do not actively use their deposits. One important factor was that especially small savers want to put away money for a "rainy day" and therefore do not touch their savings. On the other hand, an important group of inactive savers were former borrowers. They abandoned the obligatory savings accounts after they repaid their loan. They did not close their savings account and withdraw the remaining balance because the loan was the financial service that interested them and savings was only complementary.

2.4.4 Lessons learned in management capabilities, especially risk and liquidity management

2.4.4.1 Success factors

The staff recruitment procedures of BCS increasingly focus on personality traits that are crucial for the relationship between the bank and the customer. The confidence of the customers in the bank will increase when they feel well-served and communication is fluent. This is especially important for savers who must trust the financial adviser and the tellers before they will deposit their money in a financial institution. A similar trend towards strong personal attention to customers can also be detected in the training area. The improvement of training facilities is one of the top priorities of the bank.

The focus on internal promotion mechanisms in the branches helps to establish a more permanent relationship between customers and branch staff. As rotation between the branches is not frequent, branch staff is capable of building an institutional memory for their customers.

The bonus system strongly emphasizes the mobilization of savings, especially savings accounts with low financial costs. This performance incentive mechanism will soon be complemented by more qualitative criteria of customer satisfaction with bank services.

BCS takes much care to protect client savings from theft. There is a special division within the bank that is dedicated to control security devices such as safes and camera systems.

The prudential regulation of the Superintendency of Banks has raised BCS' awareness of risk management. Especially the GAP targets special risks that have largely been neglected by financial institutions.

The bank's asset management aims at reducing the risks of loan loss. The loan portfolio is composed of multiple small amounts and is diversified, which reduces risk concentration. Credit assessment and monitoring are very comprehensive and rely on specialized staff as well as software.

Liquidity management is entirely computer-based and operates with daily, weekly, monthly and yearly cash-flow projections. The planned figures and the actual income and expenses are compared on a daily basis and liquidity projections are adjusted accordingly. Therefore, the bank has a powerful instrument to identify critical liquidity shortages in advance.

An interesting feature of liquidity management is the internal liquidity recompensation procedure that operates between branches with excess liquidity and liquidity deficits. As the internal interest rate is close to the interbank rate, there is a strong incentive for each branch to mobilize its own funds to avoid a negative liquidity balance.

2.4.4.2 Limitations and risks

The bonus system is a very complex instrument and is not understood easily. Therefore, it might be difficult for branch staff to relate their daily activities to the bonus they might obtain, which in return may hamper performance. The bonus system's focus on savings mobilization might even introduce negative incentives. Some branches were encouraged to improve their savings performance by moral suasion, using access to credit as a leverage device to mobilize more savings. This, however, undermines the new corporate strategy that relies exclusively on voluntary savings. In addition, only the best national team out of 136 gets a performance bonus each month. Therefore, the overall majority of the branch teams are excluded from bonuses. Finally, the team-based approach of the bonus system might lead to a free-rider syndrome, as the bank does not assess the individual performance of each branch member.

A systematically designed MIS is not in place, which makes it difficult for management to identify exceptional situations, make timely decisions and exercise effective control.

The very complex credit cycle and the participation of different entities might introduce friction. First, information might get lost because the credit application and the credit assessment are institutionally split. Second, the division of responsibilities might become blurred. Who finally assumes the risk of a possible loan loss? Third, as the different entities involved in the credit cycle operate independently, there is little feedback. The Credit Centers do not know if the loans they assessed were finally approved or not or how they performed.

Based on the new GAP, BCS has recently become aware of potential risks in interest rate fluctuation and foreign exchange risks. Especially the risk in interest rate fluctuations must be addressed by increasing provisions. In addition, given their arrears and default rates as stated in the annual reports of the Superintendency of Banks, provisions for loan loss should be increased.

Thus far, BCS has mixed funding sources with the objective of keeping financial costs as low as possible. However, when different sources of funds are compared, it is important to consider total costs (including administrative costs). Currently, the interest rate of the interbank market shows a strong downward tendency so that the comparative advantage of savings may decrease. If this takes place, it is important for the bank to pay more attention to the cost accounting of savings in order to identify the optimal strategy for funding.

2.4.4.3 Possibilities of replication

Some elements of the staff recruitment strategy and the training facilities of BCS, which focus on improving the relationship with the customer, can easily be adapted to other financial institutions. The same is true for the bonus and internal liquidity recompensation systems. Finally, risk-adverse asset management is at the core of protecting savings and is a sine qua non for all financial institutions.

2.5 Regulatory and supervisory framework

2.5.1 External regulation and supervision mechanisms

With the promulgation of Law 45 in 1990, international banking standards based on the Agreement of Basle were introduced into the Colombian financial sector. The major reform elements that had a strong direct impact on BCS' performance include:

- The definition of the minimum capital requirement for banks (US$11.3 million); [18]
- The strict review of the personal and professional qualifications of shareholders and senior managers;

[18] The minimum capital requirement for financial corporations is US$3.5 million, for savings and housing corporations US$2.8 million, commercial financing companies US$2.1 million and for other financial institutions US$700,000 (Estatuto Orgánico del Sistema Financiero, Law 1730, Article 80, 1991).

- The limitation of risk concentration in outstanding loans,[19]
- The shift from a capital adequacy ratio based on the leverage effect on liabilities to a capital adequacy indicator of 9% based on the risk classification of assets,
- The introduction of a new credit risk classification and provision mechanism largely based on the principles of the Agreement of Basle,
- The determination of a single chart of accounts for all types of financial institutions, and
- The introduction of criteria for the sound management of assets and liabilities (GAP) in order to reduce specific risks.[20]

On-site inspections and the revision of the submitted periodic reports are carried out effectively by the Superintendency of Banks. BCS changed their credit procedures due to a recommendation by the inspectors.

The FOGAFIN has become a powerful tool to prevent bankruptcy and to stabilize the financial sector. BCS, however, has not turned to the Guarantee Fund for support because it has not registered any liquidity or solvency problems.

2.5.2 Internal regulation and supervision mechanisms

Three different internal regulation and supervision mechanisms are in effect:

- The Revisoría Fiscal;
- The Internal Auditing Department; and,
- Participation in sector-wide efforts to define rules for self-control and self-supervision.

The *Revisoría Fiscal* is a special Colombian obligatory, external control mechanism enforced by the government. The role of the *Revisoría Fiscal* is defined by the Constitution, detailed by Commercial Law and further related to the financial sector by Law 45 of 1990. In general terms, the *Revisoría Fiscal* is an obligatory auditing body that monitors the interests of the owners of a financial institution or any other company.

Compared to an external or internal auditor, the *Revisoría Fiscal* shows some special characteristics. Its work is permanent and covers all functional areas of the bank. In addition, the *Revisoría Fiscal* is an independent body, which should prevent unsound or inefficient financial operations from taking place. In addition, the *Revisoría Fiscal* advises the internal auditing department how to carry out their work effectively. Finally, the *Revisoría Fiscal* collaborates with government authorities in supervising the financial sector and must inform the Superintendency of Banks about irregularities. The law considers severe penalties in the case that the *Revisoría Fiscal* commits infractions.

In more practical terms, the *Revisoría Fiscal* carries out several daily tasks. The *Revisoría Fiscal* examines the daily correspondence of the bank as well as other internal communications. The staff of the *Revisoría Fiscal* carries out on-site inspections in the

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[19] According to Law 35 (1993), a financial institution can only approve credit to an individual inferior to 10% of total capital. However, in the case of mortgage credits, banks are allowed to approve credit to an individual representing up to 30% of the bank's capital. See Martínez Neira (1994).

[20] Superintendency of Banks, Criterios y Procedimientos para la Gestión de Activos y Pasivos, Resolution 1/1996.

branches in order to evaluate physical infrastructure (safes, hardware and software, etc.) and to ensure the correct application of procedures. In addition, the *Revisoría Fiscal* reviews and signs all documentation presented to the Superintendency of Banks in order to ensure the reliability of information. Every six months, the *Revisoría Fiscal* submits a special report to the Board of Administration (semi-annual dictum), assessing the reliability of the financial statements.

The Internal Auditing Department is a voluntary, advisory body to BCS' President and comprises 31 auditors. It develops, implements and periodically examines the internal monitoring and control procedures in order to verify that the corporate policies and procedures are respected and the information that the bank produces is reliable.

It is divided into three groups, financial auditing, operational auditing and auditing of computer systems. Each auditor is in charge of several branches and establishes a permanent relationship with them (*Auditor Dueño*). There are frequent on-site inspections. On the zonal and regional levels, there are auditing committees that exchange information and decrease the distance between the branches and the auditing division at headquarters.

Colombian financial institutions have taken initial steps toward self-control and self-supervision at the sectoral level. *Asobancaria*, founded 30 years ago, is the representative entity of the banks. Apart from providing training courses and other particular services, its major objective is to standardize performance criteria in order to foster sound financial operations. A special Risk Committee analyzes current problems and provides suggestions on how to strengthen the stability of the financial sector. The interbank agreements elaborated by *Asobancaria* are obligatory to all members. By convention, the Superintendency of Banks recognizes these decisions (Circular 072).

Five years ago, *Asobancaria* established a credit information bureau in order to screen out doubtful customers. All member institutions are obliged to report overdue (more than 30 days) and defaulted loans to this information bureau. The affiliated financial institutions can obtain information about the record of the customer with the financial system. In addition, *Asobancaria* also periodically receives information from the members similar to the reports submitted to the Superintendency of Banks and publishes them.

Recently a new entity was established to defend the interests of small customers in the financial sector (*Defensoría de los Usuarios del Sistema Financiero*). The idea for this entity came from *Asobancaria*. This institution will be an intermediary between the customer and the bank in order to settle existing conflicts without taking legal steps.[21] It is a pioneering effort in Latin America and is based on the experience of customer advisory centers in Spain, Germany and Canada.

When the new customer advisory center started, it was initially supported by 21 banks and financial corporations representing almost 40% of the institutions forming the regulated and supervised financial sector. BCS did not participate during the initial phase.

[21] The amount of the financial transaction that provokes the conflict should not exceed 90 minimum salaries (equivalent to US$15,500). In addition, the customer should not have taken legal steps yet.

2.5.3 Lessons learned in external and internal regulation and supervision mechanisms

2.5.3.1 Success factors

Strengthening of external regulation and supervision mechanisms has significantly contributed to improving the performance of BCS since 1990. Especially as a new player in the commercial banking sector, it was important for BCS to meet demanding regulations and effective supervision. This increased the awareness of BCS about important technical features (e.g., capitalization, provision policies, risk and liquidity management) and increased the security of client savings.

Though BCS has never turned to the Guarantee Fund, the bank has benefited from indirect effects of this entity. The existence of the Guarantee Fund has stabilized the entire financial sector and has increased customers' confidence in private financial institutions.

The effective enforcement of the new regulatory and supervisory regime has also become a non-financial asset of BCS in their relationship with customers. BCS strongly emphasizes that it is a supervised financial institution in order to raise the confidence of the customers.[22]

A double-check system of internal and external auditing exists. The obligatory *Revisoría Fiscal* plays a crucial role in controlling internal auditing and providing information to the owners and the Superintendency of Banks to identify problems at an early stage.

2.5.3.2 Limitations and risks

Until recently, BCS has not been in the front-line to develop and push the implementation of self-control mechanisms and self-supervision at the sectoral level. This might be partially explained by BCS' strong linkages with the foundation and the Group, which might have provided the services and synergy effects of *Asobancaria* to a large degree. In addition, it might be difficult for a new commercial bank such as BCS to gain strength in an already well-established association. However, due to a general tendency towards self-control mechanisms in the financial sector, BCS should become more active in this area.

2.5.3.3 Possibilities of replication

Strong internal control mechanisms are important to guarantee sound financial operations. They should be more specialized for more complex financial institutions that maintain decentralized components of decision-making and administration. In addition, special computer auditing is necessary the more such an institution depends on computerized data processing. In the absence of a strong partner such as the foundation, internal or external control mechanisms can be more easily developed with the support of a national or regional association or other complementary institution.

2.6 Cost analysis and savings mobilization

2.6.1 Scope and quality of accounting and cost analysis

The accounting system is ruled by the norms of the Superintendency of Banks. Since the 1990s, a single accounting plan is obligatory for all financial institutions. The Division of Accounting Services is responsible for consolidating the information that is prepared by the

[22] One example is a taped message that customers hear while they are put on hold during a telephone call to BCS. The message repeats several times that BCS is a regulated and strictly supervised bank.

regional offices. The Department for Internal Auditing monitors compliance with accounting standards. Finally, the *Revisor Fiscal* reviews the financial statements before they are passed on to the Superintendency of Banks and the Board of Administration.

Each branch operates as a profit center, it is charged for the services that are provided by the zonal and regional offices and by the headquarters. The respective fees cover all costs. In addition, the transfer price set for the internal liquidity recompensation system reflects the financial costs of interbank operations.

The bank's cost accounting system per product was started in 1995. The main objective is to calculate the total costs of each financial product. However, at this time the bank has costed the 85 most frequent financial transactions such as cashing a check and depositing money in a savings account. Thus, BCS expects to have a fully computerized cost accounting system for all financial products before the year 2,000.

2.6.2 Cost analysis of savings products

In the present study, the following cost factors have been considered:

- Direct, indirect and general costs of opening a savings account, payment of interests and administrative costs of financial transactions such as depositing and withdrawing money; [23]
- Lottery costs; and,
- Costs for other promotional activities focusing on savings mobilization.

It should be emphasized that the present cost analysis might only present an approximation of reality as not all cost factors could be considered. However, the information on various cost factors was complete and allows for reliable proxy results.

In order to obtain a more precise picture of the real costs, the savings products were divided in different categories according to type, status [24] and size. The following table summarizes the ratios between administrative costs of different types of savings accounts and the average savings amount per size category in 1996. The figures refer to savings accounts that were opened before 1996. Therefore, opening costs are not included in the administrative costs.

[23] All costs refer to cash transactions by the branch cashiers. Alternative cost calculations for ATM transactions would produce different results that are supposedly lower.

[24] Active savings accounts are defined as those accounts that show transactions during the year. Inactive accounts do not show any turnover in 1996.

Table 1: Average administrative costs per savings account in 1996 [25]

Jan-Dec 1996	Traditional savings accounts		"Grow Every Day" savings accounts	
US$*	**Active**	**Inactive**	**Active**	**Inactive**
<= 10	** 18.24%	6.56%	26.39%	8.75%
11-30	4.94%	1.39%	6.78%	1.46%
31-50	2.24%	0.57%	2.87%	0.59%
51-150	3.69%	3.16%	1.93%	0.97%
151-500	1.17%	1.00%	0.61%	0.31%
501-1,000	0.47%	0.38%	0.25%	0.12%
1,001-5,000	0.16%	0.14%	0.09%	0.04%
5,001-10,000	0.05%	0.04%	0.03%	0.01%
> 10,000	0.01%	0.01%	0.01%	0.00%
Average of all savings accounts	0.91%	4.94%	0.35%	0.92%

Source: Author's calculations based on internal information provided by Marketing Division of BCS.

* BCS uses size categories based on Colombian Pesos which have been transferred to US dollars as of December 1996.

** For example, the total administrative costs in 1996 for savings accounts below US$10 represent 18.24% of the average balance of these accounts during that year.

- In general terms, the administration of the "Grow Every Day" savings account is less expensive than the traditional savings account. This is due to the yearly payment of interest compared to quarterly paid interest on the traditional savings account.
- As it is to be expected, the administration and maintenance of actively used savings accounts is slightly more costly than that of inactive accounts, as the costs for withdrawals and deposits must be added.
- Small savings accounts below US$50 would turn out to be much more expensive if interest had to be paid and the respective administrative costs had to be considered. In this case, the cost ratios for the traditional savings accounts below US$10 would increase to 68.3% (active accounts) and 75.2% (inactive accounts) respectively. This shows that the exclusion of these accounts from receiving interest payments is an important cost-reducing measure.
- Roughly one third of the traditional and almost 10% of the "Grow Every Day" savings accounts are below US$10 (data for December 1996). Hence, a considerable portion of savings accounts entails high administrative costs.
- As far as traditional savings accounts are concerned, the tendency of decreasing administrative costs is interrupted once. The category between US$50 and US$150 shows an extraordinary peak. In order to avoid that these savings accounts turn out to be more expensive for the bank than accounts with lower balances, the bank might increase the minimum balance to classify for interest payments.

[25] For accounts below US$50 no administrative costs for interest payment were considered as these very small accounts do not classify for receiving interest.

The least expensive savings product for BCS is time deposits. The total administrative costs divided by the average amount of time deposits is 0.07%. However, time deposits represented only a quarter of total volume of deposits in December 1996.

BCS passes a considerable part of the administrative costs of the accounts to the customer. The saver must pay an opening commission and pay for the passbook, debit card and all transactions carried out with ATMs that do not belong to the bank's network. Generally, the commissions cover more than the effective cost of the specific transaction they refer to.

The commissions that are charged might screen out very small savers. A saver who opens a traditional savings account with a minimum opening balance of US$50 must pay approximately another 10% for commissions on the day of opening the account.[26]

2.6.3 Methodologies to keep operating and transaction costs low for the financial institution

Due to increasing competition in the Colombian financial sector, BCS aims to reduce operational costs and increase efficiency. In this sense, the *Fundación Social* started a project for the entire Group in mid-1996 called "Synergies." The objective of this project is to produce economies of scale and scope between the companies that form the *Grupo Social*. The project can be illustrated by the following examples that have already started to materialize:

- In order to decrease costs and benefit from the human resource potential already developed in the *Grupo Social*, the bank is required to fill existing vacancies by shifting internal staff or looking for other persons from within the Group. In addition, the training system will become standardized for the Group.
- In the near future, the management of physical resources will be centralized for the entire Group. The foundation will directly negotiate with the largest providers to achieve better prices. In addition, the providers will deliver the materials directly when they are needed to the respective branch or division.
- The foundation recently suggested introducing a Financial Management Center, responsible for the liquidity management of all of the companies of the *Grupo Social*. The Center will provide clearing and liquidity compensation services for the companies and establish links to money and capital markets.

In addition, the following measures have been taken to keep costs low:

- The branches' infrastructure and equipment are simple and modest.
- In 1994, the bank introduced ATMs in order to decrease the cost of cash transactions and increase outreach.
- In addition, PIN cards were introduced which store the most relevant information of the customers and have a security code to prevent misuse. This helps the teller to quickly check the identity of the customer and input the operation into the system.
- Costly public lotteries were replaced by more modest televised lotteries.
- The branch financial adviser will become an all-around salesperson for all financial products and services of the bank. Because the financial adviser will keep records on his or her customers and establish permanent relationships with them, information costs will

[26] The commissions are calculated for a simple savings account without debit card.

be reduced. A new data base will be developed in order to store information about each customer in a more systematic way.

- Before interest is paid, savings accounts must exceed a minimum balance. Therefore, the bank saves administrative costs for small savings accounts.
- The maintenance of inactive savings accounts with insignificant amounts is cost-intensive. Therefore, BCS will consolidate accounts with a balance below US$50 into one single group account in order to simplify administrative procedures. BCS discussed alternative procedures with the Superintendency of Banks in order to respect the rights of the savers and reduce the administrative costs for the bank at the same time.

2.6.4 Methodologies to keep transaction costs low for the savers

The branch network is currently comprised of 136 offices in more than 40 cities all over the country. The branches are strategically located, e.g. in neighborhoods with high population concentration or close to markets or shopping areas.

In addition, the bank operates 86 ATMs in strategic places where many customers live or work. Customers can use these ATMs free of charge. Some of the ATMs operate independently from a branch as so-called satellite offices. These satellite offices are located where the transaction volume currently does not justify the opening of a branch. The bank is also affiliated with the three largest ATM-networks in the country. In the past, the bank did not charge the customers for using ATMs that did not belong to BCS in order to promote the use of debit cards. Due to increasing costs for this service, the bank now charges a commission for the service. The saver must pay US$0.90 for each transaction or consultation of the account.

According to the location of the branch and characteristics of the market segment, there are extra office hours in the evening or on weekends. Small traders and businessmen especially benefit from extended office hours.

The bank has recently introduced new computer-based consultation systems. The customers can inquire about the balance of their accounts by phone. In addition, there are computer screens in some branches that can be consulted directly by the customer. In order to speed up transactions at the teller, customers can use a new PIN card.

Another important advantage to borrowers is the use of savings or checking accounts to automatically debit credit installments. In this case, the borrower does not have to pass by the branch to pay the installment on the day when it is due. The borrower can deposit the respective amount any time before it becomes due and the bank automatically debits the installment.

In some pilot branches, the bank is now introducing new financial products and methodologies for microentrepreneurs. Microentrepreneurs who apply for a loan are visited at their workplace. Though at this moment BCS does not offer doorstep services, the financial technology tested with the microentrepreneur market segment might be considered a first step towards this direction.

2.6.5 Lessons learned in the reduction of operating and transaction costs for the financial institution and the savers

2.6.5.1 Success factors

BCS branches are conceived as profit centers that are charged for the services they obtain from other BCS units. In addition, BCS is currently undertaking strong efforts to implement an extensive cost accounting system that allows to cost every financial transaction, product and customer. The main objective of the new cost accounting system is to determine areas of little and high profit to subsequently identify strategies to further improve efficiency and lower costs.

As mentioned above, BCS has taken the following measures to reduce operational and transaction costs both for the institution and for the savers:

- Major cost cutting projects undertaken by the *Fundación Social*;
- Exemption of savings accounts with balances below US$50 from interest payment;
- Differentiated interest rate structure tying the level of interest rates to the savings balance in order to partially compensate for the higher administrative costs of smaller accounts;
- Consolidation of inactive savings accounts with balances below US$50 into one single group account;
- Increasing the number and volume of non-cash transactions through the introduction of debit cards;
- Speeding up financial transactions through PIN cards, debit and credit cards, which can be used through a nation-wide ATM network; and
- Extended office hours, telephone services and autoconsulting systems.

2.6.5.2 Risks and limitations

The introduction of electronically connected services that link the branches, zonal and regional offices and headquarters could speed up the transmission of information and make it more easily accessible. Information costs would be considerably decreased.

Especially for small accounts that only meet the minimum opening requirements, the commissions for opening the account can turn out to be high. The same is true for the debit card whose fees prevent small savers from using it.

The service fee for using the ATMs that do not belong to the bank is very high for savers managing small amounts.

2.6.5.3 Possibilities of replication

The above listed key factors for successful savings mobilization at low costs can easily be replicated. However, the introduction of more sophisticated computer-based systems such as ATM services, debit or PIN cards require considerable funds and specialized personnel. In addition, the creation of synergy effects by linking the financial institution to an apex organization might be difficult for some institutions.

3 CONCLUSIONS

3.1 General conclusions

Based on the institutional analysis of BCS, there are three different driving forces that explain the successful evolution of this bank in the 1990s, especially in the area of savings mobilization.

- The reform of the financial sector, which started at the end of the 1980s, introduced fundamental changes. The exceptional institutional type of savings bank was abolished and BCS had to transform into a commercial bank. In addition, the Superintendency of Bank enforced new prudential regulations that adhered largely to international standards. This new legal and supervisory framework forced BCS to improve risk and liquidity management and to strengthen their capital base. These three aspects are crucial for the protection of savings.
- As a consequence of the liberalization of the financial sector, competition between financial institutions has increased. New financial institutions have entered into market segments that were previously served almost exclusively by BCS. In addition, financial spreads are decreasing due to severe market pressures. Therefore, BCS must improve the variety and quality of financial services, especially savings services.
- In this context, it is important to consider the increased awareness of the customers about the products and conditions that are offered. Customers have become increasingly demanding, especially with respect to the remuneration of savings.

BCS faces strong competition in the area of savings and struggles to remain competitive. Despite the long tradition as a savings institution, BCS currently loses ground in savings mobilization compared to other financial institutions. The main weaknesses of BCS' savings methodology can be summarized as follows:

- The transformation into a full-fledged commercial bank changed the image and corporate identity of the former savings bank. Hence, the development of new products such as checking accounts, bank letters and international operations has become more important and new market segments have been targeted. This shift, however, has not been easily acceptable for some customer groups that traditionally have not worked with a commercial bank and fear that BCS now pays more attention to new market segments.
- Though the new organizational structure is largely oriented towards market segments, the current savings products are not deliberately designed for specific market segments. The new *MEGACuenta* will become the first savings product that targets a specific market segment.
- The staff has not completely adopted the new corporate strategy to focus exclusively on voluntary savings.
- The computer system must be expanded and improved. The MIS might have been sufficient to cope with the information flow of a savings bank, but now the requirements to channel and process data have increased. First, the volume of information is steadily expanding. Second, record keeping of historical data has become more and more important to reduce the costs of collecting information. Third, the time between identifying a problem and making a decision about how to solve it must be shortened due to increasing market pressures.
- The learning mechanisms of the bank are only partially institutionalized. Though the bank has made some important progress in integrating customers into the institutional learning

process, a deliberately designed model for internal learning based on staff's positive and negative experiences does not exist.

3.2 Elements to be taken into account for successful savings mobilization

Lessons learned will be presented below that should be considered by financial institutions interested in strengthening savings mobilization. In the first part, elements that are especially relevant for commercial banks will be reviewed. In the second part, general conclusions for any type of financial institution encouraging small and microsavings will be summarized. Savings mobilization through commercial banks should take into consideration the following aspects:

- The organization of the bank should follow clear principles, i.e. it should be targeted toward specific market segments or products. In the case of BCS, the organizational structure is geared to meet the needs of various market segments in order to support the development and commercialization process of products that target specific market segments.
- The cooperative leadership exercised by top-level managers makes it easier to decide, coordinate and control activities in a complex structure as is characteristic of a bank. This helps to facilitate the introduction of new products and financial technologies.
- There is a clear division between administrative, commercial and control areas. Local and zonal levels focus almost exclusively on the commercialization of financial products while regional offices and headquarters are more dedicated to administrative and control tasks.
- The control span should be reasonably limited in order to facilitate the enforcement of control mechanisms.
- Access to a large branch network and ATM facilities is important for customers who travel or operate in different places and require access to their money in a short time.
- It is important to have specialized staff in headquarters in charge of developing new savings products and improving existing savings services on a permanent basis.
- When more complex savings products are introduced, market studies should be carried out in order to test the market potential and design of the product and delivery mechanisms.
- The observation of other market players and an analysis of their respective market studies related to savings should be undertaken.
- The bonus system should strongly emphasize the mobilization of savings in terms of volume and structure.
- Internal training measures should consider savings mobilization as an important component.
- In order to use information in the most efficient way, a systematic MIS should be in place. This will not only help to prepare strategic decisions, but also to carry out effective control.
- The physical security of savings must be ensured by appropriate means such as safes, armored cars, camera supervision and guards.
- Specialized staff should carry out risk management. In addition, it is important to use a broad definition of risks, including fluctuation in interest rates and foreign exchange risks.
- An appropriate internal liquidity recompensation mechanism between bank branches can provide strong incentives to mobilize savings. Branches with a negative liquidity balance must be charged high interest rates to obtain funds from the bank's internal liquidity pool.

- Internal and external supervision devices must work effectively and ensure sound operations.
- The capital base must be strong enough to cover the risks of asset management.
- An extensive cost accounting system may provide important information on the profitability of various savings products. Based on this information, the bank will find it easier to assess and improve savings products. In order to develop appropriate liquidity management and a business plan, the bank must rely on information about the total costs of different sources of funds.

Some issues addressed above are also relevant for other financial institutions. Therefore, this section will focus on special features related to small and microsavings:

- A large variety of savings products that addresses different savings motives and market segments should be offered. Savings programs should consider a mix of attractive interest rates, easy accessibility, low transaction costs for the savers, security, and additional incentives, such as lotteries.
- Lotteries have proved to be especially successful in mobilizing savings from poorer segments of society.
- In order to facilitate recognizing different savings products and identifying with them, the financial institution should consider self-explanatory names for the savings program and create a special trade mark for each product.
- Minimum opening balances should be low in order to allow small savers to gain access to savings services.
- Commissions and service fees should not be prohibitively high for small savers.
- Small savers are more sensitive to transaction costs than large savers. The use of ATM and debit cards can make savings more accessible and keep transactions costs low. A similar effect is reached by extended office hours.
- A special service culture should be developed that focuses on the small customer.
- In order to reduce administrative costs for very small, dormant savings accounts, these accounts can be consolidated into a larger group account.

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5 ANNEXES

5.1 Annex 1: Macroeconomic, financial and social data

	1992	1993	1994	1995	1996
Macroeconomic data:					
GDP (million US$)	44,910	52,307	63,278	80,853	83,500
GDP/Capita (US$)	1,233	1,398	1,645	2,045	2,055
Minimum salary per month (US$)	88.30	101.50	118.70	130.30	140.00
Sectoral distribution of GDP					
• Agriculture/GDP (%)	21.00	20.60	19.70	19.70	19.60
• Commercial sector/GDP (%)	11.20	11.60	11.70	11.70	11.40
• Industry/GDP (%)	21.20	20.50	19.70	18.90	18.50
• Services/GDP (%)	35.70	34.90	35.40	35.40	36.10
• Other/GDP (%)	10.90	12.40	13.50	14.30	14.40
Unemployment rate (%)	9.6	7.6	7.9	9.5	11.5
Financial data:					
Ann. inflation rate (consumer price) (%)	25.10	22.60	22.60	19.50	21.63
Exchange rate (COP/US$ at 31 December	738	802.7	831.3	987.7	1,005.33
M3/GDP	34.80	38.40	40.40	42.60	43.40
Gross savings rate (% GDP)	19.00	19.55	18.95	18.42	17.48
Gross investment rate (% GDP)	13.93	18.01	20.22	21.33	21.14
Av. nom. deposit rate (comm. banks) (%)	27.50	26.00	30.00	32.50	27.90
Av. nom. lending rate (comm. banks) (%)	35.20	35.80	40.40	44.00	38.90
Social data:					
Population (million)	36.4	37.4	38.5	39.5	40.6
• Rural population (%)	29.70	28.90	28.30	27.60	27.10
• Urban population (%)	70.30	71.10	71.70	72.40	72.90
Population older than 15 years	23	23.7	24.4	25.1	25.9
Population/km²	31.89	32.78	33.69	34.62	35.58

5.2 Annex 2: Institutional data

	Dec 1994	Dec 1995	Dec 1996
General information:			
No. of branches/agencies	130	134	136
No. of employees	2,012	2,499	2,727
Balance sheet structure:			
Assets (US$)	476,021,893	581,767,743	698,018,959
• Cash (%)	6.9	7.9	6.3

	Dec 1994	Dec 1995	Dec 1996
• Financial assets (%)	8.7	5.4	4.5
• Net loans (%)	71.3	72.7	72.7
• Equity investments (%)	0.0	0.0	0.0
• Fixed assets (office buildings, equipment, etc.) (%)	5.2	5.4	6.7
• Other assets (%)	7.9	8.6	9.8
Liabilities (US$)	389,603,031	505,020,755	605,434,733
• Amounts owed to private customers (deposits) (%)	92.1	85.2	87.4
• Amounts owed to financial institutions (%)	2.6	1.9	3.3
• Other liabilities (%)	5.3	12.9	9.3
Capital (US$)	86,418,862	76,746,988	92,584,226
Loan portfolio:			
No. of outstanding loans*	157,561	150,283	208,747
• Female clients** (%)	n.a.	n.a.	57.8
• Male clients** (%)	n.a.	n.a.	42.2
Vol. of outstanding loans (US$)*	347,328,762	433,625,899	526,163,150
• Female clients** (%)	n.a.	n.a.	62.3
• Male clients** (%)	n.a.	n.a.	37.7
No. of loans disbursed during the year	n.a.	84,409	74,939
Vol. of loans disbursed during the year (US$)	n.a.	332,196,811	253,923,925
% of borrowers who have tradit. sav. acc.**	n.a.	n.a.	73.7
Nominal lending rate (%)	44.6	46.4	45.4
Nominal lending rate banking sector (%)	46.5	44.2	38.3
Savings facilities:			
No. of savings accounts (traditional, Grow every Day)	1,000,744	1,089,418	1,181,999
• Female clients*** (%)	n.a.	n.a.	48.7
• Male clients*** (%)	n.a.	n.a.	51.3
Vol. Of savings accounts (US$)	224,315,158	234,785,551	277,598,153
• Female clients*** (%)	n.a.	n.a.	46.3
• Male clients*** (%)	n.a.	n.a.	53.7
No. of time deposits ("Grow Every Day," TD)	33,929	49,185	44,914
Vol. Of time deposits (US$)	103,229,857	132,021,848	153,278,376
No. of opened sav. acc./time dep. during the year	n.a.	n.a.	347,781
No. of closed sav. acc./time dep. during the year	n.a.	n.a.	251,794
No. of deposit transactions during the year of			
• Checking accounts	n.a.	n.a.	265,921
• Traditional savings accounts	n.a.	n.a.	282,872
• "Grow Every Day" savings accounts	n.a.	n.a.	191,878
No. of withdrawals during the year			
• Checking accounts	n.a.	n.a.	80,529

	Dec 1994	Dec 1995	Dec 1996
• Traditional savings accounts	n.a.	n.a.	215,004
• "Grow Every Day" savings accounts	n.a.	n.a.	195,542
% of customers with traditional sav. acc. who are borrowers*** (%)	n.a.	n.a.	13.1
% of customers with "Grow Every Day" sav. acc. who are borrowers*** (%)	n.a.	n.a.	22.8
Deposit loan ratio (savings accounts and time dep./outstanding loans) (%)	94.3	84.6	81.9
Nominal deposit rate (sav. acc. + time dep.)**** (%)	31.0	28.0	26.7
Nominal deposit rate (sav. acc. + time dep.) of banking sector (%)	37.1	33.6	28.0

5.3 Annex 3: Performance indicators

	1994	1995	1996
Operational efficiency:			
1. Av. ann. value of checking acc./av. ann. no. of staff (US$)	10,254	16,747	23,070
2. Av. ann. no. of checking acc./av. ann. no. of staff	12	14	14
3. Av. ann. value of savings acc. (trad.+GED[27])/av. ann. no. of staff (US$)	117,508	101,751	98,045
4. Av. ann. no. of savings acc.(trad.+GED)/av. ann. no. of staff	518	463	435
5. Av. ann. value of time deposits (GED, TD)/av. ann. no. of staff (US$)	47,436	52,139	54,592
6. Av. ann. no. of time deposits (GED, TD)/av. ann. no. of staff	12	14	14
7. Av. ann. value of total deposits (1, 3, 5)/av. ann. no. of staff (US$)	175,198	170,637	175,707
8. Av. ann. no. of total deposits (2, 4, 6)/av. ann. no. of staff	542	491	463
9. No. of total deposit acc. opened/av. ann. no. of staff	n.a.	n.a.	133
10. No. of total deposit acc. closed/av. ann. no. of staff	n.a.	n.a.	96
11. Value of loans disbursed/av. ann. no. of staff (US$)	n.a.	147,250	97,177
12. No. of loans disbursed/av. ann. no. of staff	n.a.	37	29
13. % of analyzed credit applications which were turned down	n.a.	22.4	23.9
14. Av. ann. value of outstanding loans/av. ann. no. of staff (US$)	158,595	173,084	183,656
15. Av. ann. no. of outstanding loans/av. ann. no. of staff	77	68	69
Liquidity:			
16. Av. ann. liquid assets/av. ann. assets (%)	8.5	7.4	7.1
17. Av. ann. liquid assets/av. ann. short term liabilities (%)	9.8	12.7	12.6

27 "Grow Every Day".

	1994	1995	1996
Risk assets:			
18. Av. capital adequacy ratio (av. capital/av. assets) (%)	17.0	15.7	13.2
19. Av. ann. arrears[28]/av. ann. outstanding loans (%)	n.a.	4.6	5.4
20. Av. ann. default rate (%)	n.a.	2.3	2.9
21. Ann. provisions for loan losses/av. ann. outstanding loans (%)	2.9	3.3	3.6
Quality of financial intermediation:			
22. Net interest margin ([interest income – interest expenses]/av. ann. assets) (%)	15.4	14.4	13.6
23. Other operating income to total assets ([other operating income – other operating expenses]/av. ann. assets) (%)	4.2	4.2	4.2
24. Spread (net interest margin + other operating income margin) (%)	19.6	18.6	17.8
25. Administrative costs/av. ann. assets (%)	12.0	12.1	12.4
26. Provisions (for loan losses and others)/av. ann. assets (%)	2.1	2.4	2.9
27. Net operational margin (spread - [adm. costs + loan provision costs]/ av. ann. assets) (%)	5.5	4.1	2.5
28. Interest income from lending/av. ann. outstanding loans (%)	38.2	37.8	37.2
29. Interest expenses/av. ann. outstanding loans (%)	16.3	18.3	19.1
30. Interest rate spread (27.-28.) (%)	21.9	19.5	18.1
Profitability:			
31. Return on assets (net operating income before tax/av. ann. assets) (%)	5.5	4.1	2.5
32. Return on equity (net operating income before tax/av. ann. capital) (%)	32.5	26.2	19.0

[28] Arrears are payments overdue for more than 30 days as defined by Superintendency of Banks.