

Managing Growth: The Organizational Architecture of Microfinance Institutions



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MICROENTERPRISE BEST PRACTICES

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Managing Growth: The Organizational Architecture of Microfinance Institutions

by

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PREFACE

This document was written to provide microfinance practitioners with ideas and suggestions to assist them with the challenging task of managing growth. Because microfinance institutions are at various stages in their growth and development, as are the markets in which they operate, not all of the points made in this text are applicable to everyone. However, as microfinance institutions mature and as their local microfinance industry becomes more competitive, many of the issues discussed here will become increasingly relevant.

In an effort to expose microfinance to new perspectives, the information in this document was derived largely from lessons in the vast business literature. The microfinance industry has evolved primarily out of the non-profit, development community. Gradually, the industry is adding pieces of expertise from the commercial world. Because of this piecemeal formalization of microfinance, microfinance institutions are not always structured or managed following the most current principles from corporate experience. For microfinance to fully establish itself as a pioneering industry, it must combine the successful practices and behaviors of the business community with the social mission of the development world.

Rhyne and Otero¹ initiated this path by outlining the financial systems approach to microfinance. They articulate the changes in perspective that are required: to consider borrowers as clients not beneficiaries, to eliminate dependence on donors, to access capital markets, to set interest rates high enough to cover costs, and to achieve sustainability. However, they did not describe the organizational architecture of these new institutions.

This study builds on their efforts by focusing on three components of microfinance institutions that are critical to managing growth: institutional culture, human resource department, and organizational structure. Together, these elements form the organizational architecture of microfinance institutions. Managing growth requires a holistic vision of the institution that considers these three elements in harmony with one another. The use of the architecture metaphor also emphasizes the importance of building durable institutions that can accommodate growth, rather than on growth itself.

This research was supervised by Carlos Castello, ACCION International's Vice President for Latin American Operations and a Research Leader on Managing Growth for the Microenterprise Best Practices Project. Maria Otero, ACCION's Executive Vice President, advised on the development of this document and edited drafts. The author wishes to thank Claudio Gonzalez-Vega (Ohio State University), Barry Lennon (USAID), and Robin Bell (DAI) for their detailed and thoughtful comments on a previous draft.

¹ Maria Otero and Elisabeth Rhyne, eds., *The New World of Microenterprise Finance* (West Hartford, Connecticut: Kumarian Press, 1994).

INTRODUCTION

Outreach and *sustainability* are two critical objectives for microfinance institutions (MFIs). As defined by Christen et al., outreach is the ability to provide quality financial services to large numbers of people, especially the very poor.² Outreach is also an indicator of the institution's social mission—to scale up and provide services to as many people as possible. Sustainability, in contrast, requires operating at a level of profitability that allows sustained service delivery without dependence on subsidized inputs. This represents the institution's commercial strategy. For MFIs, *managing growth* is the process of balancing the objectives of outreach and sustainability—balancing the social mission and the commercial strategy.

The traditional approach to managing growth relies on standardization and replication. Although this approach is valid, particularly for MFIs that do not operate in competitive markets, this study draws on lessons from recent upheavals in the corporate world where many businesses have realized that bigger is not always better. In the face of heavy competition, many corporations are now reorganizing and “right sizing” in line with new thinking on growth management. As the microfinance industry matures and MFIs experience increased competition, they are likely to conclude that lessons from the business world are increasingly applicable.

In general, MFIs have to grow. As this document will demonstrate, they are compelled to expand by their social mission and by the imperatives of sustainability. If MFIs can learn from the experiences from the corporate world, perhaps they can grow wisely and avoid the stage where the corporation becomes an unwieldy bureaucracy. Given the high administrative costs of microfinance and the need for efficiency and productivity, MFIs cannot afford to become top heavy.

Managing growth incorporates all aspects of MFIs. This document uses the metaphor of “organizational architecture” as a framework for analyzing and designing three inter-related components that are essential to managing growth: (1) institutional culture, (2) human resource development, and (3) organizational structure.³ These are not the only issues affecting growth. Governance, management information systems, resource development, and financial management, for example, are fundamental issues that must also be considered, but they are not the focus of this study. Managing growth, as defined by the three elements of organizational architecture, is the process of building solid and lasting institutions—literally, institution building. This introduction defines organizational architecture and outlines this document by describing the three inter-related components.

Organizational Architecture

To manage growth, an MFI needs to be built in the same way an architect designs and constructs a building. Like an organization, a building cannot be erected without a plan. The plan outlines not just where the walls and windows will be, but also how the plumbing and electricity will

² Robert Peck Christen, Elisabeth Rhyne, and Robert Vogel, *Maximizing the Outreach of Microenterprise Finance: The Emerging Lessons of Successful Programs*. USAID Program and Operations Assessment Report No. 10 (Washington, D.C.: U.S. Agency for International Development, 1995).

³ This metaphor is borrowed from two sources: Nadler et al., *Organizational Architecture: Designs for Changing Organizations* (San Francisco: Jossey-Bass Publishers, 1992); and Robert M. Tomasko, *Rethinking the Corporation: The Architecture of Change* (New York: American Management Association, 1993).

flow and connect all the rooms. The shape and the location of the rooms are determined by the proposed function of that space. The rooms are arranged to allow the appropriate circulation of people. In the process of building—or reconstructing—architects must balance competing forces, such as the concern for beauty with the need for energy conservation and the multiplicity of owner-specified requirements with budgetary constraints.⁴

These architectural elements are also applicable to building or reconstructing a business. Organizational architecture requires an inclusive view of the elements of design and of the social and work systems that make up a large and growing corporation. Organizational architecture includes the formal structure, such as the design of work practices; the nature of the informal organization or operating style; and the process for selection, socialization, and development of people. As companies gain equal access to capital and as many technologies mature and become widespread, organizations will gain a competitive advantage primarily from their ability to deploy and leverage the efforts of the people in the organization.⁵

The notion of architecture encourages us to focus not only on the fit between the organization and its environment, but also on the harmony among constituent design elements—architecture encourages a holistic approach to design. It invites the reader to think about building durable organizations, not just designing them. Whether an organization is a “new construction” or a “renovation,” it must be brought into being through a complex process of human interaction. The notion of architecture is an effective reminder that design is only one part of the process.⁶

Growing MFIs can use the logic of architecture to build, or rebuild, an organization that embodies the competencies and strengths of microfinance. The elements that are critical to the success in microfinance should also be reflected in its architecture. The organizational architecture of microfinance prizes speed, flexibility, and focus. It emphasizes micro. It needs to eliminate costly barriers that isolate the provider from its customers because customer service is more critical in microfinance than it is in other service sectors. The architecture of microfinance requires a congruity between the organizational design and the financial technology. As such, the institution also needs to remove internal obstacles that separate its employees, managers, and organizational units from one another, which is particularly challenging in the decentralized delivery model that characterizes the provision of microfinance services.⁷

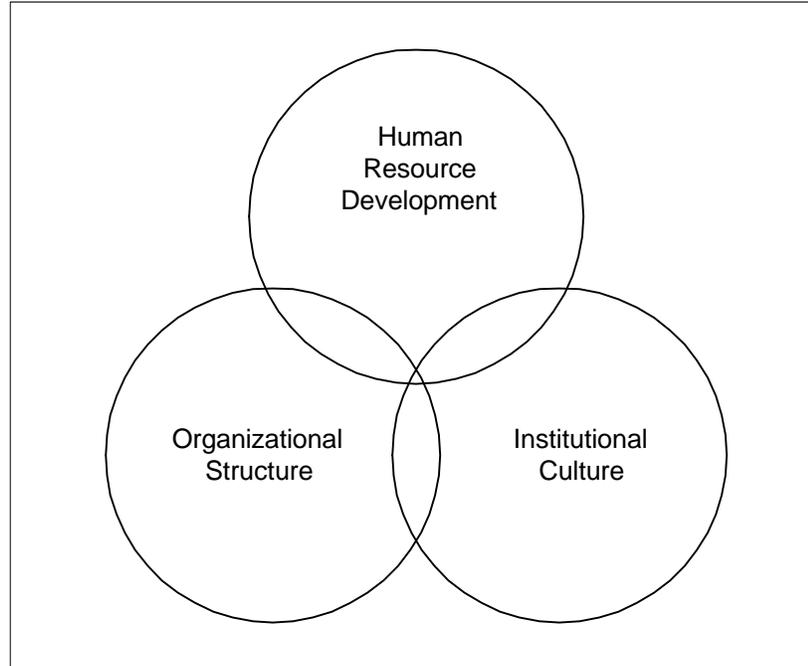
Building a building without a plan is a recipe for disaster. The same is true for a growing MFI that needs some remodeling work to accommodate its growth potential. It needs a plan that takes a holistic view of the organization and considers how the pieces fit together. The design of the organization by itself is just an empty shell—boxes on an organization chart. Inside the shell, the organization is filled people, people with skills and experience who perform important functions. The spirit and vision that motivate and guide the human resources are derived from the institutional culture. In remodeling the organization to accommodate growth, these three components must be considered collectively (see Figure 1).

⁴ Tomasko, *Rethinking the Corporation*, p. 9.

⁵ Nadler et al., p. 4.

⁶ Nadler et al., p. 13.

⁷ Tomasko, *Rethinking the Corporation*, p. 5.

Figure 1: The Components of Institutional Architecture

Institutional Culture

The institutional culture is not readily apparent in an organization chart or a training manual, but is nevertheless an essential ingredient for effective growth management. The institutional culture has two components: (1) the external culture, as the institution presents itself to its customers, suppliers, and the rest of the outside world; and (2) its internal culture, which reflects the core values of the institution and forms the basis of how people work together. As the institution grows, what happens to the institution's external and internal culture? Do the values need to change as the institution expands? How does the culture determine the types of growth strategies the firm is willing to consider and the extent to which people are committed to implementing the strategies that are selected?

During the early days of the institution, the culture may be characterized as a family approach, complete with participatory management that promotes flexibility, creativity, and innovation. This is particularly true of MFIs that begin as nongovernmental organizations (NGOs), which tend to be more informal than for-profit enterprises. Often, new businesses are led by the visionary entrepreneur who founded the enterprise with a great idea—such as providing microfinancial services to the unbanked masses.

These may be important characteristics for a young institution in an emerging industry, but can they be retained as the MFI expands? Growth may require a more structured approach. If institutions move from a dynamic to a structured management style to accommodate growth, this may necessitate a change in executive management. The challenge is to combine the advantages of a young,

entrepreneurial organization with the strengths of a more mature, professional institution. If the institution transforms from an NGO into regulated financial intermediary, what effect does the change in institutional type have on the institutional culture?

As in any service industry, one core value that has to be retained is the commitment to customer service. MFIs must retain their best clients because their larger loan sizes and the familiar relationship make it possible for the organization to balance outreach and sustainability. As the institution grows, how does it retain the commitment to customer service?

In addition to customer service, this analysis of institutional culture considers the following characteristics that create a growth-friendly environment: commitment, leadership, communication, quality, honesty, and innovation. A discussion of the culture of an MFI must also consider it within the context of the local culture. If the society in which the MFI is located is hierarchical, for example, is it realistic to advocate for participatory management? The local culture must be viewed in relation to the characteristics that are appropriate for microfinance, such as decentralization, which call for a less hierarchical approach.

Human Resource Development

The foundation of any MFI lies at the locus of interaction between the institution and its customers. This bottom-up view of the institution appropriately emphasizes the critical role of field staff as the foundation of microfinance, and places the institution's human resources as a top priority for managing growth.

A growing organization needs to hire at a pace that integrates three converging elements. First, the addition of staff must meet with the institution's ability to train and deploy human resources. An expanding institution requires systems to produce a large volume of well-trained front-line staff. Following the principles of standardization, the most recently hired staff must implement the same methodology as the first. Staff training is an ongoing process throughout the entire relationship between the employee and the firm. This may include grooming staff for management positions or increasing responsibilities without adding layers to the hierarchy by increasing the autonomy of the field operations. If MFI growth includes diversification, such as the introduction of new financial products, training needs to be designed to gradually provide staff with new skills, thus increasing their flexibility and productivity.

Second, the MFI must have the capacity to manage and motivate new staff. Incentives are an important aspect of staff development. Staff incentives increase both costs and productivity. The challenge is to increase productivity to a greater extent than the costs. Keeping salaries at low levels may save on costs, but hurts productivity. To achieve financial viability, management must keep costs in check; but to achieve outreach, staff need to be appropriately rewarded for their efforts. Managing growth involves identifying the right balance of monetary and non-monetary incentives, including base salary, individual- and/or group-based rewards, staff development opportunities, benefits, the possibility of developing new skills, and the intangible benefits derived from the institution's development mission.

Third, the pace of hiring must coincide with the demand for the institution's services, which is largely determined by the firm's marketing and outreach efforts. From these three elements, it is

possible to conclude that the planning for hiring and deploying of field staff requires strategic coordination among human resources, operations, product development, management, and marketing.

Organizational Structure

The design of the organization builds on the foundation of the field staff by shaping the relationship among the sub-agencies, branches, regions, and head office. The organizational structure evolves as the institution grows, as do the levels of responsibility at the various levels. In conceiving the organizational structure, it is useful to build from the bottom up by identifying the appropriate building blocks for the organization. Although the individual field personnel is a possible building block, the business literature suggests that a team business unit should also be considered to increase efficiency, productivity, and responsiveness to the target market.

The literature indicates that a flatter and leaner organizational structure is the preferred model for a growing institution. The most difficult path of communication goes up the chain of command. In many businesses, information tends to flow fastest across the hierarchy, from peer to peer. This is particularly true if the organizational structure minimizes walls and compartments, but instead encourages the participation of staff across the boundaries of functional departments.

Growth is dynamic. To effectively manage growth, the institutional structure should also be fluid and flexible, creating an agile organization that is responsive to changes in the market. Expanding MFIs may create a dynamic organizational structure that is decentralized. The decentralization process, while critical to managing growth, is an administrative challenge. How can an MFI decentralize responsibility and authority to the field without increasing the institution's exposure to fraud and portfolio deterioration? How can the institution devolve authority to the branch level and ensure that standard procedures are implemented consistently?

Organizational systems must be in place to cope with the increased administrative burdens that accompany more staff and more clients. Field staff can have all the skills, incentives, and motivation in the world, but their efforts are doomed to failure if the operating systems are not in place and effective.

The organizational structure must also be responsive to two key stakeholders in MFIs: customers and employees. What design emphasizes and provides the most effective customer service? How does the design allow the institution to learn the needs of its clients and then respond to them? On the staff side, it is first necessary to identify what employees want to get out of their jobs. There is a wide range of organizational behavior theories that may help in designing the organization to actualize the potential of employees.

Sources and Structure

The sources of information for this study fall into three general categories. First, there are resources that deal specifically with growth. Unfortunately, the literature on growth itself is not extensive, but the resources that do address this topic present fairly consistent and complementary perspectives. The second category is futuristic literature that considers business and management trends. Again, the sources in this category present common points of view, such as the movement toward leaner, flatter organizations and the importance of customer service. The final category includes sources that address specific management topics, such as team building and staff training.

To ensure that the organizational architecture allows MFIs to manage growth, one should understand growth, growth patterns, and the importance of growth for MFIs. The first chapter draws on the first category of literature to explore the nature of growth. This analysis views MFIs as entrepreneurial firms that experience the same stages of institutional development as all growing businesses. Chapters 2, 3, and 4 build on this understanding of growth and illuminate the three components of organizational architecture: institutional culture, human resource development, and organizational structure. In each case, the information gleaned from the literature is applied to the unique case of microfinance. The final chapter summarizes the findings from this study.

CHAPTER 1: UNDERSTANDING GROWTH

This chapter grapples with understanding growth. Is bigger better, and if growth is important how is it achieved? Since microfinance is a relatively young discipline, it is possible to look at individuals who start and operate MFIs as entrepreneurs themselves. This perspective allows us to consider the constraints or obstacles that impede the growth of entrepreneurial endeavors and apply them to MFIs. Why is growth important to MFIs, and what growth pattern is most appropriate? This chapter argues that, in building durable and sustainable institutions, it is necessary to balance quality with quantity.

MFIs have to resolve two questions: (1) what is their optimum *size*, since there are costs associated with being too small and too large; and (2) what is the right *speed* for growth, because there are costs from not growing fast enough and dangers from growing too fast.⁸

Bigger, Better, or Both?

Microfinance is a high-growth industry. It is not uncommon for MFIs to grow exponentially. PRODEM, a Bolivian NGO, disbursed less than \$3 million in 1989. In 1992, PRODEM created BancoSol, the first privately owned commercial bank dedicated solely to microfinance, and transferred its portfolio to the new institution. In 1994, BancoSol disbursed more than \$76 million, representing a 25-fold increase in disbursements over a five-year period.⁹ Another example of rapid growth is the Association for Social Advancement (ASA) in Bangladesh. Although its first full year of microlending was in 1991, by the end of 1996, ASA had approximately 530,000 borrowers.¹⁰

But these examples should not suggest that all MFIs grow and succeed. The leaders in the microfinance industry are entering uncharted and sometimes choppy, waters. Many MFIs experience cycles of high growth followed by periods of consolidation where they are forced to solve problems caused by growth, such as a deterioration in portfolio quality, client desertion, and untrained and burned-out staff, and administrative challenges including loan processing and information systems. In addition, many smaller credit programs never experience growth because they lack the resources—technical and/or financial—and a commitment to the financial systems approach.¹¹

MFIs, large and small, can benefit from the lessons learned by businesses in other growth industries—lessons of success and failure. These lessons stress that growth is not an objective of its own, but naturally results from an emphasis on quality. If there is one lesson to learn about managing growth, it should be: *growing a business means making it better, not just bigger*. In their effort to reach an increasing percentage of the market and achieve sustainability, MFIs often lose sight of other essential components of institutional growth. Unfortunately, an emphasis on quality is often lost in the pressure to expand.

⁸ This insight was provided by Claudio Gonzalez-Vega.

⁹ MicroFinance Network, *An Introduction to Key Issues in Microfinance* (Washington, D.C.: MicroFinance Network, 1995).

¹⁰ Credit and Development Forum, Bangladesh, 1996.

¹¹ As outlined by Otero and Rhyne, the financial systems approach to microfinance includes the following characteristics: to consider borrowers as clients not beneficiaries, to eliminate dependence on donors, to access capital markets, to set interest rates high enough to cover costs, and to achieve sustainability.

Pressure to Grow

Businesses must understand the pressures to grow so they can plan and prepare for it, choose the right timing for expected major changes in size, and control the speed of growth. Managers and directors of MFIs should be aware of the internal and external pressures to expand.

There are two primary *internal pressures* that push MFIs to increase their outreach: the imperative of sustainability and their social mission. Initially, MFIs have to grow. To cover their costs, MFIs need to take advantage of the economies of scale that result from better utilization of capacity. Growth is needed to dilute fixed costs over a larger portfolio. However, MFIs need to be careful about assuming that growth will automatically dilute their fixed costs. When MFIs expand, they often increase rather than reduce their overhead, as they hire new staff who are not immediately productive, as they open new offices, and as they invest in infrastructure like computer systems to support growth.

Once an MFI reaches financial sustainability, does it need to keep growing? For many MFIs, outreach is an important part of their social mission, to provide financial services to as many low-income people as possible. Although this pressure affects MFIs in varying degrees, institutions highly motivated by their social mission consider the enormous scope of demand for microfinance services as a compelling argument to expand.

External pressures also motivate the expansion of MFIs. Many MFIs operate in new markets that are starved for capital. Massive growth is possible because MFIs have introduced innovations in lending technologies that give them a comparative advantage with a large and untapped market. Institutions that engender trust and provide quality services can be overwhelmed with inquiries and applications. Growth begets growth to the point where momentum may carry the institution too far too fast.

There is no such thing as a permanent growth market—all markets mature. Donors and microfinance support organizations may consider the maturation of the microfinance market as an objective, particularly if it means that private capital floods into the informal sector and competition between MFIs improves the quality of services for target population. However, practitioners may resent or fear the entry of commercial banks and other competitors in their market. Instead of resenting the competition, MFIs need to recognize that the high growth of this market will ultimately attract new players, so it is critical to factor the effects of competition into their strategic plans. Yet the microfinance market is so vast that, in most countries, it is unlikely to mature for some time. This creates the potential for the exponential growth of MFIs—a rate of growth that is probably not in the best interests of the organization, its employees, or its customers.

There is another insidious external factor in the expansion of MFIs. They have been socialized by donors and the broader microfinance community to be obsessed with growth. One of the first questions an outsider is likely to ask a microfinance practitioner is not whether the MFI has a quality portfolio or whether it provides excellent customer service, but how many clients it has. The primary statistic reported by most MFIs is the number of clients—and the outreach standards for MFIs keep moving farther away. In the past, MFIs became significant when they had several thousand clients, but today, in many countries, the microfinance community does not acknowledge MFIs with fewer than 10,000 clients, while in Bangladesh or Indonesia, no one will look at institutions unless they have 100,000 clients. The Micro Credit Summit has established growth target for the entire microfinance

industry based on reaching 100 million borrowers by the year 2005.¹² This emphasis on quantity ignores the critical issues of maintaining quality and building sustainable institutions. Economic and social development are about institution building, but this principle is often lost in the focus on growth.

For MFIs that are not motivated by a social mission, the pressure to grow may come from other sources. Commercial banks that enter the microfinance market may be pressured to demonstrate quick results—for publicity, profitability, or other purposes—which may force them to scale up before they have fine-tuned their methodology or created internal systems to support growth.

Much has been said in the microfinance literature about creating sustainable institutions. Usually that means becoming independent of donor resources and funding portfolio growth through retained earnings, accessing capital markets, or mobilizing savings. But sustainable also means durable. MFIs must be careful about pursuing growth for growth's sake. Instead, if they focus on developing, serving, *and maintaining* a loyal customer base, they are likely to experience a natural growth rate that is in step with the capacity of the organization and does not undermine its corporate culture.

Hawkins points out that venerable companies have “being” goals rather than “doing” goals. Their business is centered on a way of interacting with the world, not on providing one specific service or product.¹³ This perspective is borne out in the research by Collins and Porras. In their book, *Built to Last: Successful Habits of Visionary Companies*, they compare 18 of the world's premiere institutions, which are widely admired and have a long track record of success, with peer institutions in their industries, which are less accomplished.¹⁴ This comparison helps to illuminate some key factors required to build durable and successful institutions. Collins and Porras' research suggests that success should be defined as something that is sustainable over time, not something that gets very big very fast, or achieves excellent short-term returns.

Young MFIs, struggling from week to week to secure funding to cover operational deficits and to feed the growing demand for loans, are forced to assume a short-term outlook. The establishment of a sustainable MFI therefore requires more than a change from donor to commercial sources of funding. It also requires a change in attitude. Through strategic planning, a sustainable MFI must develop a long-term vision for its institution, which is then reflected in the organization's relationship with its key stakeholders, particularly its staff and customers. This vision must balance quality and quantity.

Entrepreneurs in Microenterprise Development

MFIs provide financial services to micro and small entrepreneurs who are trying to grow or at least sustain their businesses. Being entrepreneurial involves doing something that no one else has done. A good business idea is exciting, imaginative, and unique. It creates value—both social and economic value.¹⁵ In their effort to provide financial services to microentrepreneurs, MFIs are being entrepreneurial themselves. They are establishing a new industry by introducing technological

¹² Micro Credit Summit Declaration, RESULTS, 1997.

¹³ Paul Hawkins, *Growing a Business* (New York: Fireside, 1987), p. 80.

¹⁴ James C. Collins and Jerry I. Porras, *Built to Last: Successful Habits of Visionary Companies* (New York: Harper Business, 1994).

¹⁵ Hawkins, p. 40.

innovations and breaking some of the rules of traditional finance. As entrepreneurs, microfinance practitioners face the same challenges of starting and growing a business as any other entrepreneur.

There is an excitement in an emerging business. Entrepreneurial businesses are lean and flexible, and can quickly respond to changes in the market. There is a heady sense of mission in an entrepreneurial firm that motivates underpaid and overworked employees to maximize their productivity and uncover their creativity.¹⁶ This enthusiasm is enhanced in a new MFI because the organization's social mission is profoundly compelling. However, businesses cannot be run indefinitely on enthusiasm and excitement. One of the greatest challenges for new enterprises, including MFIs, is making the transition from emerging to emergent. Is it possible for a large and growing company to maintain its entrepreneurial edge?

The Edward Lowe Foundation describes this transition as “overcoming the brick wall” that separates emerging from emergent. Its research with entrepreneurs has identified the following six guiding principles to ignite business growth and restore entrepreneurial success:¹⁷

- (1) ***Reinvent the Vision.*** Many emerging entrepreneurs have the simple vision of a positive profit-and-loss statement. To climb the brick wall, the firm's vision has to achieve more than profitability. It has to motivate and challenge staff, and inspire excellence. It needs to provide direction and serve as the institution's guiding light.
- (2) ***Succeed with Persistent Opportunities.*** Successful entrepreneurs always have an eye open for new opportunities. They cannot pre-plan every move they make. Instead, they leave themselves room to react to sudden opportunities. They are never comfortable where they are, but instead are always looking ahead and asking, “What's next?”
- (3) ***Surrender Sovereignty.*** The most challenging transition for most entrepreneurs is devolving responsibility to management specialists. As the business grows, the entrepreneur will eventually reach the point when it is not possible to make every decision. Successful entrepreneurs recognize this, and are able to let go and listen to and work with the people they hire.
- (4) ***Become Your Competitors' Worst Nightmare.*** The zealous pursuit of customer satisfaction is the best way to secure a competitive advantage. Successful entrepreneurs indicate that the key is to make customer satisfaction the central focus of the company, with no boundaries on the imagination about how or how much to satisfy customers.
- (5) ***Nurture the Entrepreneurial Spirit.*** A continual influx of new thought is part of the process of growth. Successful entrepreneurs say that, as the company grows, the encroaching bureaucracy stifles employee's entrepreneurial spirit and therefore the firm must find ways of nurturing and rewarding that spirit.
- (6) ***Develop Teamwork.*** Teamwork paves the road to business success. Teamwork is a way of getting employees to be aligned toward a common goal and to feel they are a

¹⁶ Stephen Harper, *The McGraw-Hill Guide to Managing Growth in your Emerging Business* (New York: McGraw-Hill, 1995), pp. 9-13.

¹⁷ Edward Lowe Foundation, "The Guiding Principles of Entrepreneurial Success" (East Lansing: Michigan State University).

part of the company, not observers. The whole is greater than the sum of its parts. Teamwork also helps to maintain the culture of smallness as the company gets bigger.

These six principles are all applicable to MFIs. The *vision* for a mature and growing MFI is likely to be different from a start-up institution, although the MFI's mission—to provide financial services to low-income communities—will remain unchanged. The new vision may include taking advantage of new *opportunities*, such as introducing new products or operating in new areas. Entrepreneurs who start MFIs are likely to reach a point where they need to *cede control* to managers and bankers who have the professional and technical expertise to run a large and growing institution. Without a strong commitment to *customer service*, the linchpin of microfinance, an MFI will not experience growth. Although some MFIs may provide one or two financial products, the micro market demands more diverse options. If the institution is not committed to *innovation* and meeting the demands of its customers, other financiers, either formal or informal, will encroach their market. And, last, many MFIs have already realized that the most effective way of fulfilling their vision is through *teamwork*.

Harper outlines seven stages of new venture evolution, shown in Figure 2. These stages present a useful framework for managing growth because they indicate where businesses have come from and suggest a direction for them to go toward.

Most well-developed MFIs are in transition from stages 4 through 6. In addition to discussing the key challenges during these stages and providing some suggestions to solving these challenges, this document attempts to describe the elusive 7th stage and how MFIs might achieve this goal.

Learning Organizations

Tomasko suggests that the key to sustainable growth is knowing how to adapt to circumstances that are constantly changing. The long-term winners are the best adapters, but are not necessarily the winners of today's race for market share.¹⁸ Young MFIs are expert adapters. They constantly tinker with their lending methodology to perfect their approach, reduce delinquency, and increase productivity. But MFIs need to ensure that they do not lose their entrepreneurial adaptability when they standardize their procedures and scale up. This suggests a continued role for market research and product development.

An adaptable organization has adaptable employees. The atmosphere is tolerant of mistakes, which are viewed as opportunities to learn. *Productive failures* are mistakes that generate new insight and understanding because they are not hidden, but are mined for all they are worth. An adaptable organization utilizes failure as a clue that initial targets, and perhaps some of the assumptions behind them, need rethinking. It listens to employees, customers, and the marketplace, and is willing to change directions in midcourse if necessary.¹⁹

According to Hawkins, businesses often lull themselves into failure because they are unable to learn what the immediate business environment is saying. Enterprises often fail because of the sum total of seemingly inconsequential events acting upon them than because of a sudden disaster. Business growth is a learning process. Only an organization that does not presume to know will be

¹⁸ Robert M. Tomasko, *Go For Growth* (New York: John Wiley and Sons, 1996), p. 32.

¹⁹ Tomasko, *Go For Growth*, pp. 34-38.

able to detect and use fresh new information from its environment. Managing growth involves being on the ground, learning from experience, meeting customers and staff, understanding their problems and concerns—and doing something about them.²⁰

Figure 2: Seven Stages of Venture Evolution

Stages of Venture Evolution	Description
1. <i>The Entrepreneurial Stage</i>	An entrepreneur identifies an opportunity and conceives a new venture.
2. <i>Extra Pair of Hands</i>	The venture takes off and the entrepreneur hires people to increase productivity to meet the growing demand. During this stage, there is a heavy emphasis on growth and very little emphasis on management.
3. <i>Delegation to Supervisors</i>	The entrepreneur realizes that she or he cannot make all the decisions and reluctantly delegates some supervisory responsibility to middle managers.
4. <i>Professional Manager</i>	The firm's increasing size and complexity require a higher level of sophistication. At this stage, the firm makes an important transition from an informal structure to a formal hierarchy.
5. <i>Building the Management Team</i>	Prior to this stage, the business operates on a functional basis, with each manager addressing his or her own areas. The firm is now at the point where the functional systems need to be integrated into an overall business plan.
6. <i>Managing the Strategic Side</i>	Once the operational side is operating smoothly (stage 5), the entrepreneur, senior management, and the board of directors can focus on strategic management, including developing and implementing a multiyear vision for the business.
7. <i>Corporate Entrepreneurship</i>	At this stage, through strategic planning, the business merges its entrepreneurial roots with its professional management to combine the best of both worlds.

Source: Harper, *Guide to Managing Growth*.

The Edward Lowe Foundation defines wisdom as the accumulation of experiences—good and bad. Successful entrepreneurs recognize the need to give their managers the freedom to make decisions and build their confidence. This empowers the management team and makes it easier for the chief executive officer to manage growth. A central part of igniting people's passions and entrepreneurial drive is giving them the opportunity to make decisions and take risks. People generally put more into their work when they are doing something they helped develop and they believe in.²¹

Growing businesses will always have problems. No ultimate solution will solve everything. An important aspect of managing growth is your attitude toward problems. If you perceive problems as opportunities in disguise, you will be in a better position to expand your understanding of what your

²⁰ Hawkins, pp. 197-199.

²¹ Edward Lowe Foundation.

business does and how it does it. A good business has interesting problems; a bad business has boring ones. Good management is the art of making the problems so interesting and their solutions so constructive that everyone wants to get to work on them.²²

Successful MFIs, like Bank Rakyat Indonesia (BRI), the Grameen Bank in Bangladesh, K-Rep in Kenya, and BancoSol in Bolivia, are accurately described by what Tomasko calls “rule breakers.” As rule breakers, they adapt new technologies and methodologies to do something that most banks would never consider. The rule breakers that achieve dramatic success combine new ideas from several domains: “That’s the difference between having an interesting new innovation to sell and being sufficiently innovative to pioneer a new industry.”²³ Microfinance combines the domains of economic development and finance to forge a distinct identity, and perhaps even a new industry. Tomasko describes rule breakers as having missions, not just jobs, and an all-or-nothing commitment to their work.

The all-or-nothing work environment in a rule-breaking corporation, when combined with innovation, timing, and good luck, may produce explosive growth—like the 50-100 percent increase in portfolio size experienced by many MFIs. However, these are not conditions for sustainable, *durable* success. The initial success experienced by a rule breaker may go to its head. It may develop a walk-on-water mentality and dwell on past success rather than build for the future.

To accomplish longevity, rule breakers need to become rule makers by setting the standards for their industry and challenging the market to beat them at their own game. But rule makers also have their weaknesses. There is a tendency for rule makers to become too comfortable with the status quo. Instead, they need to remain restless and self-critical, and constantly focus on doing things better.²⁴ MFIs that become rule makers need to guard against its pitfalls, such as becoming too rigid and not being able to adapt to changes in the market. Although this is probably not an immediate concern for most successful MFIs, as their local microfinance market matures, it will become an increasingly important issue.

Growth Patterns

Gonzalez-Vega et al. describe two types of growth: intensive and extensive.²⁵ Intensive growth, or adding depth, results from increased productivity of existing capacity. This may be possible through technological innovations; improvement in the utilization of capacity, such as increasing loan officer productivity; or introduction of new products. Extensive growth, in contrast, adds breadth by increasing capacity, such as hiring new staff and opening new offices. Managing growth requires finding the proper mix between depth and breadth to balance outreach with viability.

Growth can be described as either “jeopardizing” or “healthy.” Jeopardizing growth compromises the quality of the institution—for example, through high delinquency or poor customer service. Jeopardizing growth can lead to the inability to fulfill financial commitments, including debts

²² Hawkins, pp. 37-39.

²³ Tomasko, *Go For Growth*, p. 63.

²⁴ Tomasko, *Go For Growth*, Chapter 6.

²⁵ Claudio Gonzalez-Vega, Mark Schreiner, Richard L Meyer, Jorge Rodriguez-Meza, and Sergio Navajas, “BancoSol: The Challenge of Growth for Microfinance Organizations,” in Harnut Scheneider (ed.), *Microfinance for the Poor?* (Paris: Organization for Economic Cooperation and Development, 1997).

and disbursements, or the overextension of human and financial resources. Ultimately, jeopardizing growth will undermine the organization. Healthy growth, in contrast, is sustained over time; it is durable.²⁶

Unidimensional businesses, which focus on one product or market, are subject to jeopardizing growth. MFIs are exposed to this concentration risk because their clients often come from a single market segment that is vulnerable to exogenous systemic shocks. Most MFIs have specialized portfolios that consist solely of informal sector clients. Although an institution may have thousands of loans to diverse industries, natural disasters or changes in government regulations could affect the MFI's entire market. The reliance on one loan product exposes a similar vulnerability of MFIs, particularly if a competitor introduces a more attractive innovation.

To shield themselves from concentration risks, businesses may chose diversification as a growth strategy. But there are also management challenges associated with product and market diversification. Businesses court disaster when they stray from their core competencies by growing into areas where management does not have expertise. Success in one area may spawn overconfidence, which allows management to think it can accomplish anything. There is a headiness, optimism, and excitement associated with rapid growth. This leads to an inclination to overlook the weaknesses.²⁷ The downfall of CorpoSol, an MFI in Colombia, is a good example of an institution that grew too quickly and moved away from its core competencies.

Yesterday's growth strategy frequently drives today's organization. What is needed instead is for today's organization to provide the foundation for tomorrow's growth path.²⁸ Tomasko identifies two dimensions of growth: direction and propulsion. Direction is generally set by the senior management team, and then refined through the planning process that involves the rest of the company. To establish direction, one leader is not enough. Executives of companies that exhibit strong growth surround themselves with a broad range of personalities and perspectives, following the logic that the best defense against myopia is diversity.

Once a direction is set, energy must be marshaled to move the business forward. This is propulsion. To propel an organization toward growth, companies need to utilize all three components of the organizational architecture effectively. The business may appeal to the *institutional culture*, to employees' sense of identity and idealism, by using a common vision of where the business is going. Growth-oriented companies garner propulsion from their *human resources* by selecting appropriate performance measures and coupling them tightly to staff incentive and reward programs. It is also necessary to ensure that barriers implicit in the *organizational structure* are removed to allow the company to propel itself toward growth. For example, if senior management is too far from the interaction between the company and its clients, the organization may lose opportunities as communication trickles up through approval layers in the hierarchy.²⁹

According to Hawkins, the proper way for a business to expand is by releasing growth. The worst way to grow is to push growth. Every business has a natural rate of growth. If that rate is not reached, a business can shrivel. If it is surpassed, the business struggles to keep pace:

²⁶ Harper, pp. 3-4.

²⁷ Harper, pp. 35-38.

²⁸ Tomasko, *Go For Growth*, p. 252.

²⁹ Tomasko, *Go For Growth*, pp. 229-233.

One of the most important functions of the founder/manager of any business is sensing what that “inherent” growth rate should be, and adhering to it. The founder’s job is not to lead the “troops” to new heights. Rather, it is to draw out and moderate the changes that will be required of everyone as the business grows.³⁰

The natural rate of growth will depend on the organization’s preparedness and ability to learn. MFIs need to sense their natural rate of growth and be prepared to slow things down. The most perilous period in a company’s development is when it starts to succeed wildly and expands rapidly. When a company grows exponentially, problems may not appear until it is too late. The exhilaration of growth can occlude problems of morale, planning, and institutional capacity created by it. Success often hides weaknesses that lay just below the surface. Those weaknesses may arise with a vengeance and undermine the organization’s accomplishments. Fast growth and durability are often incompatible.³¹ The pursuit of growth is like running a marathon rather than a sprint. Runners need to pace themselves.³²

Growth changes the character of the business. It tends to breed the need for more growth. But rapid expansions are often followed by rapid declines. Growth by fits and starts may be evidence of poor management. The growth patterns of MFIs often resemble roller coasters, escalating to peaks before plunging into troughs. Because extensive growth implies the creation of new capacity, such as opening new branches, and because of changes in seasonal demand, growth will invariably have a start-and-stop nature. However, the peaks and troughs can and should be tempered to create a healthy working environment and a sense of continuity among staff and customers.

Although rapid growth is not inherently bad, it can be. Rapidly expanding MFIs are likely to experience excessive or premature growth. *Excessive* growth occurs when the rate of expansion exceeds management’s ability to stay current and to focus on the big picture. Under excessive growth conditions, management may be too blinded by rapid growth to realize they are not serving the market particularly well. MFIs that do not operate in competitive markets are particularly vulnerable to growth at the expense of customer service. *Premature* growth occurs before institution’s systems are in place and when procedures are not sufficiently tested. In both cases, the institution will ultimately suffer from increases in delinquency and desertion.

If growth causes an organization to become a victim of success, according to Harper, it is likely to be manifested by at least one of the following three maladies. MFI are vulnerable to all three of these growth effects:³³

- (1) ***Overexpansion.*** Businesses that overexpand make commitments beyond their available resources and allow debt to rise too quickly. In microfinance, this could be associated with opening new offices before the methodology is perfected or before the operating systems are ready to support growth. The danger of overexpansion is that it increases average costs and increases the risks of delinquency and fraud. Because growth usually raises the percentage of new borrowers in the portfolio, who have

³⁰ Hawkins, p. 92.

³¹ Hawkins, pp. 92, 223.

³² Harper, p. 59.

³³ Harper, p. 59.

smaller loans, overexpansion reduces the per unit return and increases the average cost per dollar lent.³⁴

- (2) ***Under-capitalization.*** Businesses need reserve capital to absorb shocks. Management may underestimate the financial or human capital required to meet growth demands. In microfinance, this is particularly problematic when MFIs do not have loan capital to keep pace with the flow of applications and the demand for increasingly larger loans. If disbursements are delayed for cash-flow problems, the quality of the portfolio is likely to plummet because the primary motivation for repayment is the promise of future loans.
- (3) ***Ostrich Management.*** Managers engrossed in the daily demands of growth may be unaware of changes occurring around them, including the regulatory environment, the demands of the market, the competition, and available technology. For example, MFIs that have historically operated in monopoly markets have had difficulty adjusting to a competitive environment. This could be attributed to the fact that management was so focused on internal issues that it did not see the competition coming. This is particularly challenging if the competition utilizes a more effective or more attractive technology. In most markets, MFIs grow largely because of unmet demand, not because they do an exceptional job at meeting their clients' demands. As a result, it is particularly important that MFIs be wary of ostrich management. If they are not providing an exceptional service, sooner or later MFIs are bound to experience competition.

Approaches to Managing Growth

Every successful business begins with one person, one idea, and one location. The difference between a business that flourishes and one that withers is how it is managed. Growth rarely involves doing more of the same on a larger scale. Growth brings complexity and requires adaptations.³⁵ This section describes tools and approaches that may be useful to persons who are trying to manage growth. The approaches include standardization, planning, management information, and marketing.

Standardization

The most common approach to managing growth is through standardization. Once a business has a well-developed product or service, it develops procedures for standard delivery on a large scale. This is particularly effective in a large market with mobile customers who want to rely on the quality of a standardized product. McDonald's is an excellent example of a company that has grown by creating a standard model, which it replicates again and again around the world. A Quarter Pounder tastes basically the same in Beijing as it does in Baltimore.

The standardization approach, although very successful, is not without its disadvantages. Standardization is associated with a bureaucratic approach that is prone to inflexibility. It does not easily facilitate learning and responsiveness. Standardization makes it difficult for the firm to respond

³⁴ This insight was provided by Claudio Gonzalez-Vega.

³⁵ Harper, p. 17.

quickly to changes in customer demands, challenges from the competition, or unique features of local markets. McDonald's has developed methods of overcoming these limitations. For example, although it is possible to get a Quarter Pounder in all McDonald's restaurants, in Amsterdam you can wash it down with a Heineken and in Tokyo you can get sushi on the side. Neither Heineken nor sushi is available at a McDonald's in Baltimore.

For MFIs, the standardization of procedures is critical. Because of the high costs and the need for large-scale outreach, MFIs have to keep their procedures simple and efficient. Standardization involves not only perfecting the methodology, which evolves over time, but also communicating it effectively and ensuring proper implementation. As a result, the keys to standardization in microfinance are staff training and quality control. The most recently hired loan officer must follow the same procedures as the most experienced loan officer. MFIs that achieve significant scale rely heavily on standardization. Once they refine their methodology, they design training and management information systems to replicate their model repeatedly. They also monitor the performance of field staff to ensure they do what they are supposed to do, and understand why they are supposed to do it.

Standardization must be used cautiously. Standardized credit products may reduce the quality of customer service. As MFIs get larger, key decision makers get further away from their customers. If standardized products no longer meet the needs of customers, or if a competitor provides a product that better meets their needs, an MFI that relies on standardized products will have difficulty developing new products, retraining staff, and securing its market share.

Most MFIs today, however, do not experience problems with too much standardization because they are not large enough, and they do not operate in a competitive market, for it to be an issue. Instead, the problem lies with not enough standardization. One branch may have completely different policies and procedures from another, resulting in wide variations in branch performance and inefficiencies that undermine the productivity of the MFI. Only once the microfinance industry matures in a particular country will the problem of too much standardization become a problem.

Planning

There is a common joke about a tourist who stops and asks a local person for directions. The local resident tries to explain several different routes, but eventually concludes, "Nope, you just can't get there from here." When a business is trying to go somewhere, it helps to plan the route before it sets out on its journey. Planning helps determine if indeed you can get there from here.

Managers of growing companies have the ability to deal with events that are separated in time. They know there is a long wait between the time something happens and the time its consequences are apparent.³⁶ For example, there is a delay between hiring new staff and the point at which they become productive. There is a delay between the decision to increase the marketing budget and an increase in demand. Managers need to anticipate what lies ahead and prepare for the challenges associated with growth.³⁷ Businesses that fail to plan for the future will have no future.³⁸

³⁶ Tomasko, *Go For Growth*, p. 30.

³⁷ Harper, p. 3.

³⁸ Harper, p. 189.

Planning requires imagination and foresight. Imagine what your business will look like in three years. What loan products are being offered? How many loan applications are processed each month? How many new field staff are trained each month? What systems need to be put in place now to achieve this vision? If this vision requires training four times more loan officers per month, the staff training department will require some reinforcements. If they have not done so already, staff trainers should develop a curriculum to train trainers; if they do not start soon, by the time they need the curriculum, it will be too late.

If the vision requires introducing new financial products, either for current clients who have outgrown existing products or to tap into new markets, the research and development phase needs to begin right away. It takes at least the length of one loan term to pilot a new product, and if that product requires refinement before it is introduced on a wide scale, the time period will be even longer. The vision may require strategic alliances, perhaps with organizations that offer business skills training or other entrepreneurial support services. If strategic alliances fit into the plan, it is important to start researching long before committing to a relationship to ensure potential partners share common commitments to quality and customer service. Last-minute decisions may link the organization with the wrong partners.

Everyone knows how important planning is, but it often gets overshadowed by the daily demands of operations. It is impossible to prepare a three-year plan when today's priority is meeting the demands for tomorrow's loan disbursement. Many managers have a fire-fighting approach that never allows them to plan for the medium or long term. They will not be able to manage growth. Without a commitment to planning, management is destined to have a short-term time horizon and be bogged down in operational matters.

Planning identifies what needs to be done, when it needs to be done, who will be responsible for doing it, what resources will be required, and how the resources will be funded. Harper considers planning a state of mind. It is the responsibility of the senior management to ensure that tomorrow is better than today, but managers are often full of excuses, such as:

- I don't have time to plan.
- My time is too valuable. Planning can be delegated.
- Things are changing so quickly it is impossible to plan.
- I started this business without a plan, so why do I need one now?
- Plans are like straitjackets. They keep me from being flexible.
- We'll cross that bridge when we come to it.
- It is too hard to set goals. There are too many external factors that can affect whether we achieve them.

Of course none of these excuses holds up to scrutiny. What could be more important for a chief executive officer than identifying where the firm should be going and developing a path to get there? If the world did not change, there would be no need to plan. Management's job in a growth-oriented firm is to identify emerging opportunities and find ways of capitalizing on them. "You cannot

drive at 65 miles per hour while looking through the rearview mirror!”³⁹ A business at the start-up phase has very different needs than an enterprise in growth mode.

Plans should not restrict flexibility. Instead, the planning process should broaden the perspective of management so it can see new opportunities.⁴⁰ Growth failures frequently occur when, rather than moving toward other paths, a company meets adversity with a renewed commitment to do more of the same. Sustaining growth over the long haul, across decades for example, requires skill at changing course.⁴¹

If the firm does not set goals, managers cannot be accountable for performance. A plan is not a nicely prepared document that sits on the shelf. Managing growth requires managers to refer to their plans regularly, compare progress and time frames to the objectives, and update or revise according to changes in the marketplace.⁴²

Planning is a critical aspect of all three components of organizational architecture. For *human resource* development, planning determines the hiring patterns. It is also an integral component of performance reviews and rewards. It is possible to enhance the commitment of staff to growth by involving them in setting their performance targets. If staff are committed to the plan, the extent to which they achieve its goals must be linked to their rewards. Regarding the *organizational structure*, the planning process helps architects realize that a rapidly growing firm needs a dynamic design. The design can shape and direct the institution’s pattern growth only if it is integrated into the long-term vision. With regard to *institutional culture*, the planning ethos must be firmly imbedded in the consciousness of employees of a growing firm.

All employees, from the top to the bottom, must consider planning a priority, although the time horizon perspective will vary depending on the staff person’s level within the organization. Tomasko differentiates between organizational levels by their time horizons. At the bottom level, the planning time horizon may be one or two months; at the layer above that, middle managers may see a one to two year horizon, which corresponds with budgets and projections. At the senior management level, the time horizon may be three to five years.⁴³

Management Information System

A growing business needs to have an effective management information system in place prior to an explosive growth phase to enable it to manage growth. Most emerging firms get into trouble because the management team either does not have the information it needs to make the right decisions or chooses to ignore the information that is available. For microfinance, information is even more important than in most businesses. It is the lifeblood of an MFI. Microfinance relies an information-based lending technology, as opposed to commercial banks that use a collateral-based approach.

Microfinance information must focus on financial as well as non-financial indicators, such as productivity, efficiency, average loan size, and client retention. The management information system

³⁹ Harper, p. 189

⁴⁰ Harper, pp. 185-198.

⁴¹ Tomasko, *Go For Growth*, p. 227.

⁴² Harper, pp. 185-198.

⁴³ Tomasko, *Rethinking the Corporation*.

should provide information about factors and forces that need to be monitored closely as well as insights into what should be changed. This early warning system can scan the horizon for trends, and identify threats and opportunities.⁴⁴

An important feature of a management information system is the selectivity of information. The quality and timing of information should be tailored to the needs of decision makers, not programmers or accountants or donors. Information should not just include current and historic data, but also include projections for the future. A comprehensive information system will not only improve the quality of management's decisions, but it will also increase the firm's ability to secure debt financing, offer stock, acquire other firms, and engage in strategic alliances.⁴⁵

Once the business identifies its key performance indicators, management should determine what constitutes each factor's green (safety), yellow (caution), and red (intervene) zone. For example, considering the portfolio at risk indicator, the MFI may decide that anything below 5 percent is in the safety zone.⁴⁶ The yellow zone may be between 5 and 10 percent, in which case the red zone would be anything above 10 percent. The longer it will take to correct something, the more closely the risk indicator should be monitored. If small changes in a performance indicator can have a major impact on the firm's performance, as is the case with portfolio quality, the yellow zone should be very narrow.⁴⁷

If factors affecting fluctuations of an indicator, like client retention, are not wholly within the control of employees, wider caution zones are appropriate. Clients may choose not to renew their loans for business or personal reasons that have nothing to do with the quality of the service provided by the loan officer. Therefore, if more than 75 percent of the eligible clients apply for repeat loans within a given time period, that may fall within the green zone; perhaps the red zone is anything less than 50 percent.

Management should determine the appropriate bandwidths in consultation with staff about what is realistic. The zones may move over time as the institution strives to continually improve its performance. It is helpful to reference the results achieved by the best in the industry, the rule makers, to realize what is ultimately possible. For example, if MFIs are aware that operational efficiency—as measured by the administrative expenses over the average loan portfolio—for the rule makers ranges from 8.5 percent for BRI to 14.5 percent for Grameen, they can strive to achieve those standards.⁴⁸ Targets should also be linked to the performance that is necessary to achieve institutional objectives, such as financial self-sufficiency.

Managing growth is a function of measuring growth. The indicators monitored reflect and reinforce the corporate culture and the firm's approach to expansion. If an MFI widely publishes its number of branches as a performance indicator, it considers geographic expansion as an appropriate and desirable growth strategy. If an institution uses its portfolio size as a key indicator of growth, it may encourage increases in loan size at the expense of increasing the number of clients. If the company uses the number of clients per loan officer as a key performance indicator, it is probably concerned with productivity.

⁴⁴ Harper, p. 311. These issues as they pertain to microfinance are discussed in detail in *Banking Services for the Poor: Managing for Financial Success* by Robert Peck Christen (Washington, D.C.: ACCION International, 1997).

⁴⁵ Harper, p. 313.

⁴⁶ Portfolio at risk is defined as the outstanding balance of all loans delinquent for 30 or more days / total outstanding balance.

⁴⁷ Harper, p. 311.

⁴⁸ Christen et al.

It is common to find a tightly focused executive team trying to move a business in one direction, while the performance measures and incentives are motivating behavior in a different direction. Common visions come to life only when a structure, like the management information system, supports them. The reverse is also true.⁴⁹ It is important for organizational architects to consider growth within the firm's big picture to ensure that performance indicators and performance incentives, organizational design and institutional culture, and flow of information are all aligned to achieve and reinforce common objectives.

The information system can also assist the organization in adopting a flatter organizational structure because the layers of middle managers who analyze and interpret data will become less necessary. Software that uses graphics to present easily understood tables and graphs provides senior management with information they can easily assess, including summary and detailed information on far-flung business units. The availability of this information may make management more willing to allow a flatter organizational structure. At the same time, readily available and easily understandable performance data at the branch level are essential for field staff to monitor their own performance. It is not possible to do microlending if field staff do not have key portfolio information in their hands every day. If field staff have clearly identified performance targets, and they have access to and understand regular performance indicator reports, the MFI will have less need for middle managers to control their performance.⁵⁰

Marketing

Marketing is the process of pursuing both extensive growth, by achieving market penetration in new areas, and intensive growth, by increasing its density of coverage in existing offices. As an element of managing growth, marketing also needs to find a balance. A zealous marketing strategy could generate a greater demand than the MFI can handle, or it could cause the institution to grow too rapidly. MFIs may not consider marketing as an approach to managing growth. In fact, many MFIs do not even have formal marketing strategies. In some locations, there is such a great demand for microfinancial services that the organic growth generated by word of mouth may be more than the office can handle.

However, not all offices have a problem with too much demand. In some cases, MFIs have to develop marketing strategies to generate interest in their financial services. The critical marketing challenge for young MFIs is to ensure that the branch, and the institution as a whole, have the capacity to deliver what they promise. A new office will be completely discredited if loan officers prepare a stack of loan applications and accept application fees if applicable, and then the institution does not have sufficient loan capital to fill demand.

For MFIs that operate in competitive environments, like Bolivia and Bangladesh, marketing is a critical strategy to recruit new clients and to retain existing ones. In managing growth, marketing helps to determine the institution's growth pattern. If an MFI pursues an intensive growth approach, where the institution attempts to increase the productivity of its existing human resources by implementing new technologies and/or new products, the MFI needs a marketing strategy to inform and educate its current and prospective customers about this new approach. If the MFI follows an

⁴⁹ Tomasko, *Go For Growth*, p. 244.

⁵⁰ Joseph H. Boyett and Henry P. Conn., *Workplace 2000: The Revolution Reshaping American Business* (New York: Plume, 1991), pp. 82-84.

extensive growth pattern, where it seeks to hire new staff and open new offices, it needs to develop a marketing strategy to introduce the institution to new communities, including canvassing local microenterprises and enlisting the support of community leaders and opinion leaders in the informal sector.

Harper outlines the three “U’s” to growth, which indicate how marketing strategies reflect the business’s growth pattern:⁵¹

- (1) ***Finding New Users.*** Market research conducted by McDonald’s indicated that the firm had few older customers. In response, the fast-food chain initiated an advertising campaign targeting the elderly as new users of its service. In microfinance, this suggests that the approach commonly used by most MFIs to find new clients could be tailored to find new types of clients for their existing products. For example, the Alexandria Business Association in Egypt, which lends primarily to male microentrepreneurs, is designing marketing strategies to attract female borrowers.
- (2) ***Increasing Usage.*** An advertising campaign by orange juice growers several years ago stated that “orange juice is not just for breakfast anymore.” This was an attempt to convince customers to use their product more often. For MFIs, this approach is synonymous with increasing loan size. Most programs establish artificial maximum loan amounts that are linked to the loan number, especially for the first few loans, but the programs usually do not have empirical evidence to demonstrate the degree of increased risk and subsequent loan loss that would accompany increases in the maximum amounts. In some cases, it may be possible to increase usage by raising loan ceilings without increasing the risk.
- (3) ***Finding New Uses.*** Arm & Hammer, a manufacturer of baking soda, uses marketing to indicate that its product is not just for baking; it also absorbs odors in the refrigerator and in the sink, and can be used for brushing teeth. MFIs can also find new ways to use their products. This might mean providing loans for fixed-asset investments, in addition to working capital, or for purposes other than enterprise development, such as consumption or housing.

With regard to marketing, it is important to understand a fundamental difference between a typical firm and a microenterprise institution. Selling more orange juice is appropriate because the identity of the drinker does not matter. Selling more loans, however, is *not* always appropriate because the identity of the borrower does matter. Finding new users may increase the risk for the MFI by forcing it to accept riskier clients; increasing usage or finding new uses, by making larger loans or new types of loans to the same clients, may make it more difficult for borrowers to repay.⁵²

MFIs need to identify their approach to growth to determine their marketing strategy. MFIs at different stages in their institutional development will assume different growth strategies. In addition to the institutional stage, various factors must be considered in developing a growth approach, such as the financial and human resources required, the risk and the potential return, and the time frame. Ansoff’s

⁵¹ Harper, p. 74.

⁵² This insight was provided by Claudio Gonzalez-Vega.

Product Market Matrix,⁵³ outlined in Figure 3, presents four different growth approaches depending on the mixture of new or existing products and markets.

Figure 3: Ansoff's Product Market Matrix

Markets	Existing Products	New Products
<i>Existing Markets</i>	Market Penetration	Product Development
<i>New Markets</i>	Market Development	Diversification

MARKET PENETRATION

The strategy of market penetration tries to get more mileage from existing products and markets. This is the same as standardization: doing more of the same on a larger scale. Although the strategy may include opening new offices in new geographic markets, the demographics of the firm's market do not change. The main risk associated with this strategy is that a business is likely to encounter competition as the market matures. If the business has not invested in research and development, a more innovative competitor may usurp its market. This is particularly the case if management, which is not looking at the horizon for new opportunities, becomes so focused on operations it does not see a shift in customer interests that could cause the market to dry up. This approach is most common strategy for MFIs.

MARKET DEVELOPMENT

Market development involves taking existing products to a new target market. Firms employing the market development approach broaden their reach to include a different set of potential customers. An example of this strategy is a firm that has a product for individual consumers that it tries to market to government agencies or corporations. In microfinance, an MFI that provides loans primarily to street vendors may try to broaden its market to include a higher representation of manufacturing or service firms. Market development encourages management to view its business as a customer problem-solver rather than a business that sells products. By developing new markets, the firm reduces the likelihood it will get caught in the quicksand of being a one-product, one-market business. However, in its effort to find new markets, the business must not overlook the importance of updating the product or improving its services.

PRODUCT DEVELOPMENT

The logic to the product development growth strategy is that, because the firm already understands its customers, it should be able to develop additional products to meet their needs. The decision to choose this approach is based on the premise that it is too difficult or too costly to attract new customers, or it is less expensive to get current customers to spend more money on each visit. In microfinance, cross-selling loan products to the same clients is extremely risky, but an MFI's borrowers may need other financial products such as savings services and insurance. In addition, the product needs of current clients may change. An MFI that uses the solidarity group methodology, for example, may develop an individual loan product after realizing that group loans are not addressing the

⁵³ Harper, pp. 75-84.

needs of its clients with rapidly growing businesses. The product development strategy reduces the risk of technological obsolescence, and encourages the firm to experiment and bring new people into the business who have different perspectives. However, this approach limits the firm's potential market. In addition, the business must guard against spreading itself too thin and becoming product driven instead of customer driven. This approach must be led by market research to ensure that the business does not lose sight of customer needs.

DIVERSIFICATION

The diversification approach is a two-dimensional growth strategy for a firm that wants to introduce new products and enter new markets. This involves greater risk than the other approaches, and it may place a strain on cash flow and profitability. Since the firm has to learn many new things at once, it is easy to make mistakes. These risks are exemplified by the case of CorpoSol, a now-bankrupt MFI in Colombia, which almost simultaneously launched three new untested microfinance projects: Mercasol, a chain of retail outlets for microentrepreneurs to purchase supplies with credit lines; Agrosol, a rural credit program with borrower groups of 20 or 30 clients and different repayment schedules than the urban program; and Construsol, a home improvement loan scheme. The diversification approach may move a business away from its core competencies. CorpoSol not only entered an unfamiliar rural market, but it also initiated retail activities, which required a completely different set of skills than providing financial services. The business world is littered with successful firms that tried to enter markets that were too far from their strengths, and failed. This approach works best if the firm enters related markets and deals with related technology, product, or type of service.

When a company competes on the basis of its unique core competencies, it usually wins. Yet competing on competencies does not mean that a company has to narrow its strategic focus to just a few product lines and risk being at the mercy of the downturns of a narrow segment of a highly volatile market. A company that competes on its core competencies can and does have the best of both worlds. It can produce a wide range of products and compete in highly diverse markets, yet still have a strategic focus and continuity of product innovation it needs to increase its likelihood of success in new endeavors. Honda, for example, makes cars and motorcycles, as well as lawnmowers, snowblowers, outboard motors, and generators. It is strategically focused while pursuing diverse markets.⁵⁴

In developing new products, MFIs need to view the borrowing needs of a customer within the context of its total financial needs, exploring all cross-sell opportunities. Most banks, while espousing a complete relationship with their customers, in fact sell only one or two products to any single customer. They fail to capture the full potential of the small business relationship. Cross-selling and customer retention go hand-in-hand. As the financial institution develops a broader relationship with its clients, including personal as well as commercial accounts, it gets a tighter grip on customer retention.⁵⁵

⁵⁴ Joseph H. Boyett with Jimmie T. Boyett, *Beyond Workplace 2000: Essential Strategies for the New American Corporation* (New York: Penguin Books, 1995), pp. 45-47.

⁵⁵ Charles B. Wendel, *Maximizing Small Business Growth: Developing a Bank's Game Plan* (Philadelphia: Robert Morris Associates, 1996).

Microfinance Growth Strategies and Institutional Development

One key factor determining the growth strategy of an MFI is its stage in development. Christen et al. outline three stages of institutional development, as shown in Figure 4.⁵⁶

Figure 4: Stages of Development for Microfinance Institutions

<p>Level I Start-up Programs and MFIs that Are Heavily Subsidy Dependent. They require frequent injections of funds. If these injections are not forthcoming, the program will quickly consume its capital in financing routine operations.</p>
<p>Level II Programs that Have Achieved Operational Efficiency but Not Full Self-Sufficiency. The range of MFIs at this level include those that rely extensively on soft money to those on the verge of unsubsidized profitability.</p>
<p>Level III MFIs that Have Achieved Full Self-Sufficiency. They generate enough revenues to cover both non-financial and financial costs, calculated on a commercial basis. Subsidies in the form of concessional funds are no longer needed, and investors can expect a return on equity equivalent to returns available elsewhere in the private sector.</p>

At each level of institutional development, a different growth strategy is required. MFIs at Level I have not fine-tuned their lending methodology, and probably have not developed the institutional capacity to support growth. Level I is an experimental phase, and the experiments should be small. This allows for a lot of trial and error while keeping the losses from mistakes within bounds. Level I institutions cannot afford the overhead expenses involved with opening up new branches or hiring new staff. These programs should rely on intensive growth by finding ways to increase the productivity of its existing capacity. This may be possible through technological innovations, such as refining the lending methodology, and improvements in the utilization of capacity, such as increasing loan officer productivity. These organizations are probably not ready to implement any marketing strategies because they do not want to cultivate demand they cannot satisfy. Planning for MFIs at this level will remain short term because projections beyond one or two years will have no basis. They are also not prepared to introduce new products or enter new markets unless they have concluded that their current product or market will not be successful, and they want to try a completely new approach.

The range of Level II institutions makes it difficult to generalize about their growth strategies. MFIs at the bottom end of the range may hire additional staff to increase the utilization of their existing branch capacity, but are not ready to open new branches. As MFIs move toward the upper end of the Level II spectrum, and assuming they have perfected their methodology, then standardization and replication of their branch model become an option. Their market-penetration strategy requires they have their staff training, management information, and other operational systems in place to initiate an extensive growth strategy that replicates a successful branch model in new geographic areas. The planning horizon become longer as the institution is better able to predict the outcome of hiring new staff and opening new offices. MFIs at the upper end of this range will probably also increase their investments in research and development so they can prepare themselves for a competitive environment and can improve the quality of service they offer their clients. If the institution operates in

⁵⁶ Christen et al., pp. 10-11.

a narrow geographic area, it may choose to invest more heavily in developing new products for new demographic markets rather than opening new offices.

Typically, MFIs have emphasized horizontal as opposed to vertical growth—that is, MFIs have grown by opening new offices in new areas rather than increasing the size, scope, and market penetration of existing offices. This emphasis contradicts the lessons from the business literature. Horizontal growth increases the overhead costs of the institution because it needs to rent, furnish, and supply more branches when its existing overhead is not being fully utilized. Management ratios are usually smaller as the business replicates its branch model, whereas adding more staff per manager would increase management productivity. Horizontal expansion adds complications, particularly with regard to communication, that may undermine the success of the institution. MFIs that expand horizontally are usually rolling out one or two products on a large scale. In doing so, if they do not continue to focus on product development, competition with a better product could seriously threaten profitability. An MFI that has expanded horizontally will find it very difficult to introduce changes to its products quickly, or to introduce new products.

Serious horizontal growth is possible only once an MFI reaches Level III. A profitable Level III institution can leverage its equity to fund a more dramatic growth strategy that is likely to include opening a significant number of new offices. It is important for institutions at this stage to reduce their concentration risk by diversifying their products or markets. Unless the competitive environment forces the issue, these institutions should probably not initiate a diversification growth strategy, which requires both product and market development. MFIs that reach this level today can be classified as rule makers, which automatically makes them targets of smaller, but perhaps more innovative, competitors. A Level III institution must guard against ostrich management and complacency by continually striving for improvement—moving the safety zone—and ensuring that it meets the needs of its market.

This chapter outlined some of the risks and challenges associated with growth, and introduced various growth strategies that are applicable to microfinance. Managing a MFI is like an entrepreneur managing a new business. As the business grows, the challenges of managing growth evolve. Successful entrepreneurs, and successful MFIs, keep their eyes on the horizon and prepare for the challenges ahead. Organizational architecture provides entrepreneurs with the tools necessary to manage growth. The following chapters each address one of the three pillars of organizational architecture: Chapter 2 covers institutional culture; Chapter 3 addresses human resource development; and Chapter 4 reviews organizational structure.

CHAPTER 2: INSTITUTIONAL CULTURE

Every business has a distinct culture. It reflects the values of the firm and its attitudes about change, technology, and risk. The firm's culture also affects what decisions are made, how they are made, and how well they are implemented.⁵⁷ Corporate culture affects management's attitudes toward customers, employees, shareholders, and competitors. These attitudes determine the types of growth strategies the firm is willing to consider and the extent to which people are committed to implementing the strategies that are selected.

Institutional culture also includes the informal procedures that emerge in the organization's operations. Sometimes these complement formal arrangements by providing structures to aid work accomplishment; in other situations, they may emerge in reaction to the formal structure—to protect individuals from it.⁵⁸ Organizational architects need to consider the unwritten rules that guide the behavior of employees and determine if they are contributing to or detracting from the growth of the business. In a rapidly growing organization, tensions may emerge between the old institutional culture and the organizational structures that are required to support growth.

One cannot see the corporate culture. It is not a budget line item, and it does not have a monetary value. But it does have an economic value. In successful institutions, culture represents one of the most important assets of the organization. According to Tomasko, for a growing company to succeed, growth has to be a part of the corporate culture. "Being a part of something bigger than ourselves and building something that can outlast ourselves are important cravings."⁵⁹ Growth is an anxiety-producing process that requires vision, courage, tenacity and cunning...but it is better than the alternative.⁶⁰

The bottom line for an expanding organization is how it positions its employees for growth. Organizations shape the way people interact. An organization is focused on moving forward when talk about growth permeates conversations throughout the company. No company can go for growth unless its employees want to get there just as much.⁶¹

But should growth itself represent the business' core value? The information presented in Chapter 1 suggests that a durable institution should focus on values that create growth rather than on growth itself. This chapter first describes the importance of ideology and vision in the corporate culture of a growing organization. It then considers cultural characteristics that can create an environment that is conducive for growth, including commitment, leadership, communication, quality, customer service, and innovation.

Ideology and Vision

A key step to building a durable, growing company is to define and articulate its core ideology. Collins and Porras state that ideology has two components: core values and purpose. Core values are the organization's essential and enduring tenets, not to be compromised for financial gain or short-term

⁵⁷ Harper, p. 159.

⁵⁸ Nadler et al., p.51

⁵⁹ Tomasko, *Go For Growth*, p. 13.

⁶⁰ Tomasko, *Go For Growth*, p. 17.

⁶¹ Tomasko, *Go For Growth*, p. 261.

expediency. Core values, such as those shown in Figure 5, do not sway with the trends of the day, nor do they shift in response to changing market conditions.

Figure 5: Examples of Core Values⁶²

Company	Core Value
3M	Thou shall not kill a new product idea Our real business is solving problems
Boeing	To eat, breathe, and sleep the world of aeronautics
Ford	People are the source of our strength
Hewlett-Packard	We exist as a corporation to make a contribution
Johnson and Johnson	We have a hierarchy of responsibilities: customers first, employees second, society at large third, and shareholders fourth
Merck	We are in the business of preserving and improving human life. All our actions must be measured by our success in achieving this goal
American Express	Heroic customer service and the encouragement of individual initiative
Marriott	Make people away from home feel that they're among friends

The purpose is the set of fundamental reasons for a company's existence—why does the company exist in the first place? When properly conceived, the organization's purpose is broad, fundamental, and enduring. A successful company continually pursues but never fully achieves its purpose—like pursuing a guiding star.⁶³ For example, “Disney can evolve—from rinky-dink cartoons, to full-length animated movies, to the Mickey Mouse club, to Disneyland, to box office hits, to EuroDisney, and to who-knows-what in the twenty first century—yet never outgrow the core task of ‘bringing happiness to millions.’”⁶⁴

Some MFIs are experiencing a similar evolution—from a start-up project, to an NGO, to a regulated financial institution. In doing so, the MFI too must not lose sight of its purpose. A change in institutional type, from NGO to bank, for example, should not necessitate a change in the relationship with the clientele. If the purpose of the business is to provide access to financial services to help customers solve their problems, the only change the customer should experience is an improvement in service because the new institutional type would allow the MFI to offer a greater array of services.

During the early days of a non-profit MFI, the institution may have an intimate culture, complete with participatory management that promotes flexibility, creativity, and innovation. These are important characteristics for a young institution in an emerging industry, but can they be retained as the MFI expands? The ultimate objective is to strike a balance to achieve the best of both worlds by combining the advantages of a young, entrepreneurial organization with the strengths of a mature, professional institution.

Most of the visionary companies researched by Collins and Porras did not begin life with a well-articulated core ideology. In the early stages, they just tried to generate cash flow. Their ideology became clear only as the company evolved. Based on their findings, for a growing company to become

⁶² Collins and Porras, pp. 68-71.

⁶³ Collins and Porras, pp. 73-79.

⁶⁴ Collins and Porras, pp. 77-78.

durable, it eventually needs to articulate its core values and purpose.⁶⁵ Most MFIs, in contrast, do begin with a clear social mission as their core ideology. In successful institutions, this provides them with the strength to carry through the lean early years of trial and error. The challenge for growing MFIs, particularly those that become for-profit companies, is to develop an institutional culture that is consistent with their original mission.

“How can we be sure that core ideologies of highly visionary companies represent more than just a bunch of nice-sounding platitudes—words with no bite, words meant merely to pacify, manipulate, or mislead?”⁶⁶ Collins and Porras provide two answers. First, social psychology research indicates that when people publicly espouse a particular ideology they become more likely to behave consistent with that perspective, even if they did not previously hold that point of view. Second, and more important, visionary companies do not merely declare their ideology. They take steps to ensure the ideology pervades the organization, through orienting new employees, nurturing the development of in-house leadership, and aligning corporate goals and strategies with the core ideology.⁶⁷

Management’s concern for the present—no matter how successful the business—must be complemented with a vision of where the firm will be in 7 to 10 years.⁶⁸ This vision makes the core ideology real and applied. The corporate vision spells out what markets the firm will be in, its anticipated size in terms of employees and assets, and whether it will be a domestic and global enterprise. The vision should also indicate whether the firm will be publicly traded and whether it will acquire other firms. Developing the vision does not replace long-term planning; it facilitates the planning process. Like the purpose, the corporate vision serves as the North Star in every decision to be made by every manager at every level every day.⁶⁹

Collins and Porras found that organizations often have inspiring visions, but do not take the crucial step of translating their intentions into concrete terms. Even worse, they tolerate organizational characteristics, strategies, and tactics that are misaligned with their intentions, creating confusion and cynicism. To turn vision into action, consider the following steps:⁷⁰

- (1) Develop a compelling vision of the future;
- (2) Translate the vision into a strategic plan;
- (3) Communicate the vision and the plan;
- (4) Motivate employees to embrace the vision and the plan so they permeate the firm; and
- (5) Monitor progress to achieving the objectives outlined in the plan.

With the adoption of values, it is important to ensure that there are no misalignments among human resource development, the organizational structure, and institutional culture. Growing MFIs should consider the values discussed below in their effort to define their core ideology and vision.

⁶⁵ Collins and Porras, p. 79.

⁶⁶ Collins and Porras, p. 71.

⁶⁷ Collins and Porras, p.71.

⁶⁸ Harper, p. 124.

⁶⁹ Harper, p. 128.

⁷⁰ Harper, p. 128.

Commitment

When a business is able to couple employees' personal values with those of the company, it creates incredibly strong, cost-effective incentives. Young microfinance programs are often very successful in this because they hire people who believe in the firm's social mission. Employees are more willing to give up some of their autonomy and make personal sacrifices when they feel bound through the vision of a shared objective. The less this commitment is felt, the more concerns about individual welfare and personal entitlements become paramount.⁷¹

Corporate culture affects the extent to which people are committed to implementing the strategy that is selected. For example, a firm that has placed emphasis on face-to-face customer relations may find its employees reluctant to introduce technologies that minimize personal attention. This can have a serious impact on the organization's growth strategy.⁷²

If the organization values customer service and quality, employees' commitment to those values will ensure that growth patterns will not undermine those tenets. However, if the business values growth for growth's sake, jeopardizing growth is likely to result. The following comparison between retailers Wal-Mart and Ames helps to illustrate this point:

CEOs at Ames recklessly pursued disastrous acquisitions in a blind, obsessive pursuit of raw growth for growth's sake, gulping down 388 Zayre stores in one bite. In describing Wal-Mart's key ingredient for success, (CEO) David Glass said "Wal-Mart associates will find a way" and "Our people are relentless." Ames CEO of the same era said, "The real answer and the only issue is market share."⁷³

Ames' pursuit of market share eventually destroyed the company, whereas Wal-Mart's emphasis on its employees has made it one of the most successful retail companies in the United States.

The strength of the institutional culture is determined by the degree to which values are shared by people throughout the organization. If management espouses a set of beliefs, but staff fail to internalize them, the firm does not have a strong culture. In weak corporate cultures, employees are reluctant to make decisions because there is no clear sense of direction. Without a widely accepted set of values and priorities, staff wait for management to tell them what to do and how to do it. A weak culture, therefore, can undermine an institution's growth strategy.

This strength of culture is most evident in the visionary companies researched by Collins and Porras, which are described as cult-like. "Because the visionary companies have such clarity about who they are, what they're all about, and what they're trying to achieve, they tend to not have much room for people unwilling or unsuited to their demanding standards."⁷⁴ The successful firms indoctrinate people into the corporate culture, impose a tightness of fit, and create a sense of belonging to something special through concrete items, such as:⁷⁵

⁷¹ Tomasko, *Go For Growth*, p. 235.

⁷² Harper, pp. 169-170.

⁷³ Collins and Porras, p. 37.

⁷⁴ Collins and Porras, p. 121.

⁷⁵ Collins and Porras, pp. 135-136.

- Orientation and ongoing training that contain ideological content such as teaching corporate values, norms, history and tradition;
- Internal “universities” and training centers;
- On-the-job socialization by peers;
- Hiring young employees, shaping their mindset, and promoting from within;
- Unique language and terminology that reinforce a frame of reference and a sense of belonging to a special, elite group;
- Corporate songs, cheers, affirmations, and pledges that reinforce psychological commitment;
- Tight screening processes, either during hiring or within the first few years;
- Incentive and promotion criteria linked to the corporate ideology;
- Awards, contests, and public recognition to reward those who display behavior consistent with the ideology;
- Celebrations that reinforce successes;
- Plant and office layout that reinforces norms and ideals; and
- Constant written and verbal emphasis on corporate values, heritage, and the sense of being part of something special.

Microfinance rule makers have already learned many of these lessons. The Grameen Bank, for example, employs many of these methods, and more, in the promotion of its institutional culture. In addition to some of the items listed above, to ensure that its employees internalize its philosophy of poverty alleviation, Grameen requires trainees to prepare a client case study by interviewing a poor woman and writing her life history including her economic and social coping strategies.⁷⁶ Grameen even cultivates its culture among its clients, through its group meetings and the promotion of its 16 principles.

Tomasko cautions that if the corporate culture is too strong, however, employees may not be sufficiently critical of the organization. It is important to cultivate a diversity of opinions to prevent stagnation. Nelson Mandela said that power can make people forget their mandate. In public life, journalists play the role of detached analysts, ensuring that the powerful do not forget the demands of their constituency. In private businesses, the market can play this role, but by the time the firm learns its lesson, it may be too late. Instead, corporations need middle managers and front-line staff to assume this role and challenge the status quo. They are closer to the customer needs, market trends, and emerging technologies than the senior managers. The lower levels of the hierarchy also have less at stake in rationalizing past strategic decisions.⁷⁷

⁷⁶ Elisabeth Rhyne and Linda S. Rotblatt, *What Makes Them Tick? Exploring the Anatomy of Major Microenterprise Finance Organizations*. ACCION International Monograph Series No. 9 (Washington, D.C.: ACCION International, 1994), pp. 72-73.

⁷⁷ Tomasko, *Go For Growth*, p. 140.

People may participate in their work without being committed to it. A bacon-and-egg breakfast metaphor helps differentiate between participation and commitment. The chicken, by laying the eggs, certainly *participated* in making the breakfast, but the pig was *committed* to it.⁷⁸ Although growth does not require employees, like the pig, to give their lives for their jobs, it does require a high level of commitment and strong culture. A strong culture, however, is not necessarily an appropriate culture. An ideal situation is a strong culture that supports the implementation of the firm's growth strategy *and* encourages adaptation so the company can evolve to meet changing conditions in the market.⁷⁹

In many young MFIs, staff are highly committed to the target population. They are adaptive because they understand that the lending methodology is evolving and they are willing to work toward fine-tuning it. But there is a tendency, once the systems are in place and the organization moves into growth mode, to lose the adaptability edge and, to some extent, the commitment. The adaptability of the organization must not end once the MFI rolls out its basic loan products on a large scale. To retain the commitment of its employees, ensure that it stays ahead of the competition, and continue to demonstrate its commitment to its customers, the MFI must realize that adaptation and innovation are ongoing processes.

Like other businesses, MFIs have three sets of key stakeholders: employees, customers, and shareholders.⁸⁰ *The firm's culture reflects the relative priority given to each of set of stakeholders.*⁸¹ Commitment goes both ways. Firms that provide tangible demonstrations of their commitment to their key stakeholders will be able to expect the same from them:

Employees. A strong corporate culture should place an emphasis on human resources that will attract, retain, and motivate people who are innovative and want to be in the vanguard. "If the firm places a premium on its people, then it needs to create an atmosphere that makes the firm the best possible employer to the people it wants to attract and keep."⁸²

Customers. Customer retention is the basis for growth. To retain its customers, the business must demonstrate its commitment to them by adapting to meet their needs and providing excellent customer service. The firm's commitment to its customers is described in detail later in this chapter.

Shareholders. To have sufficient resources, a firm must generate enough returns to keep shareholders happy. However, Collins and Porras found that maximizing shareholder wealth was not the dominant driving force or primary objective of most visionary companies. "Profitability is a necessary condition for existence and a means to more important ends, but it is not the end in itself....Profit is like oxygen, food, water and blood for the body; they are not the *point* of life, but without them, there is no life."⁸³ This suggests that returns to shareholders may be a natural outcome of an emphasis on the other two key stakeholders.

⁷⁸ Harper, p. 172.

⁷⁹ Harper, p. 174.

⁸⁰ For a non-profit organization, the term "shareholder" would have to be loosely interpreted to include donors, wholesale funders and microfinance support institutions that have a financial stake in the success of the program.

⁸¹ Harper, p. 177.

⁸² Harper, p. 180.

⁸³ Collins and Porras, p. 55.

A growing business must be careful to sustain its culture during periods of rapid growth. An important factor in the perpetuation of its core ideology is the retention of its experienced employees. In a period of high growth, if the business has problems with staff turnover, the new staff will quickly outnumber the old hands. Take the example of an MFI with 100 loan officers, a 50 percent growth rate, and a 25 percent staff turnover rate. If only experienced loan officers are leaving the business, at the end of one year the MFI will have 150 loan officers and half of them will have less than a year's experience. Some MFIs grow at faster rates and have higher turnover ratios. With so many new people, the firm may begin to lose its corporate history and culture. It also does not receive a sufficient return on the investment that it makes in its employees — in terms of screening, hiring, orienting, and training — if they do not stay with the organization.

Minimizing staff turnover is critical for a growing company, and this can be achieved in part by demonstrating a commitment to its employees. One way to express this commitment is to build the organization around employees. If the business follows this approach, which is discussed in detail in Chapter 4, its core values and philosophies must emphasize that the firm believes in involving people and placing trust in them. People need to be trusted to make important decisions about their work activities.⁸⁴

Leadership

Leadership has a significant impact on the institutional culture, although the extent of its importance is debatable. Some of the literature suggests that the chief executive officer and senior management determine the corporate culture. For example, Harper points out that management cannot afford to leave the formation of corporate values, beliefs, and priorities to chance.⁸⁵ According to Drucker, the foundation of effective leadership is thinking through the organization's mission, defining it, and establishing it, clearly and visibly. The leader sets the goals, sets the priorities, and sets and maintains the standards. Leadership is a responsibility, not a rank or privilege. Because effective leaders know they are ultimately responsible, they are not afraid of strength in associates and subordinates.⁸⁶

Although these are important points, one should also recognize that the chemistry between people can create their own informal arrangements. The challenge for management is to identify the institution's informal culture and to work with it, as suggested in the following example:

When the State University of New York held a major gala to unveil a new part of the campus, visitors thought the college had forgotten to put in sidewalks. The buildings were all up and signs posted telling you how to get around, yet there were no paths between the buildings. "We figured we'd wait for a year, to see where people actually walked, and then pave over those routes," (said) the proud dean. "That just seems to make more sense than

⁸⁴ James H. Shonk, *Team Based Organizations: Developing a Successful Team Environment* (Homewood, Illinois: Business One Irwin, 1992), p. 37.

⁸⁵ Harper, p. 175.

⁸⁶ Peter Drucker, *Managing for the Future: The 1990s and Beyond* (New York: Truman Talley Books/Dalton, 1992).

pouring concrete and watching people trample the grass because we hadn't picked the paths where people walked."⁸⁷

Durable, sustainable companies have to remove their dependence on one individual, charismatic leader. Collins and Porras believe that it is not the quality of leadership that separates the best companies from the rest. Many companies have excellent leadership. It is the continuity of quality leadership—particularly home-grown management—that preserves the core ideology. The most successful companies have better management development and succession planning than their less accomplished peers.⁸⁸

The leadership of successful MFIs can be characterized as visionary. MFIs are often started by successful business persons who want to do more with their talents than earn money; they want to help other people earn money. When they start a small microfinance project with the great idea of rocking the financial system by using innovative approaches to provide unbanked communities with financial services, their leadership and charisma are instrumental in carrying that fledgling organization through the lean years. But when the MFI experiences success, and begins to grow exponentially, the business may need a different set of leadership skills. Instead of a visionary, the MFI needs a manager. In some cases, the visionary who started the business may not have the skills necessary to manage a large and growing business. The transition from a visionary leader to a professional manager can be traumatic. Only durable institutions can survive the departure of their founders.

Following the assumption that leadership plays an important role in guiding the institutional culture, it is worth considering the role of the chief executive officer—or the executive team—in managing growth. According to Harper, the chief executive officer is responsible for planning strategic growth and opening up bottlenecks. Chief executive officers with a clear vision for business growth are less likely to be seduced by short-lived opportunities that rob their business of resources. Vision serves as the foundation for the strategic plan, which provides operating objectives, timetables, and budgets. The executive team cannot spend all its time on operational matters. They must also look for long-term growth opportunities and make a serious investment in the future.⁸⁹ Executive managers split their time by adopting trifocal vision. First, they oversee daily operations, including current customers and products. Second, they deal with unexpected circumstances—fire fighting. And, third, they are responsible for strategic planning and managing for the future.⁹⁰ Without vision, one cannot be a leader. Leaders need to communicate that vision, and to sell it.

Communication

The chief executive officer sets the tone for communication in the business. If he or she is open, sharing, and attentive to what other people in the company say, the chief executive officer will see this transparent behavior in employees. If the chief executive officer is reticent with information, others will follow suit.⁹¹

⁸⁷ Gerald Ross and Michael Kay, *Toppling the Pyramids: Redefining the Way Companies are Run* (New York: Random House, 1994), p. 13.

⁸⁸ Collins and Porras, pp. 174-175.

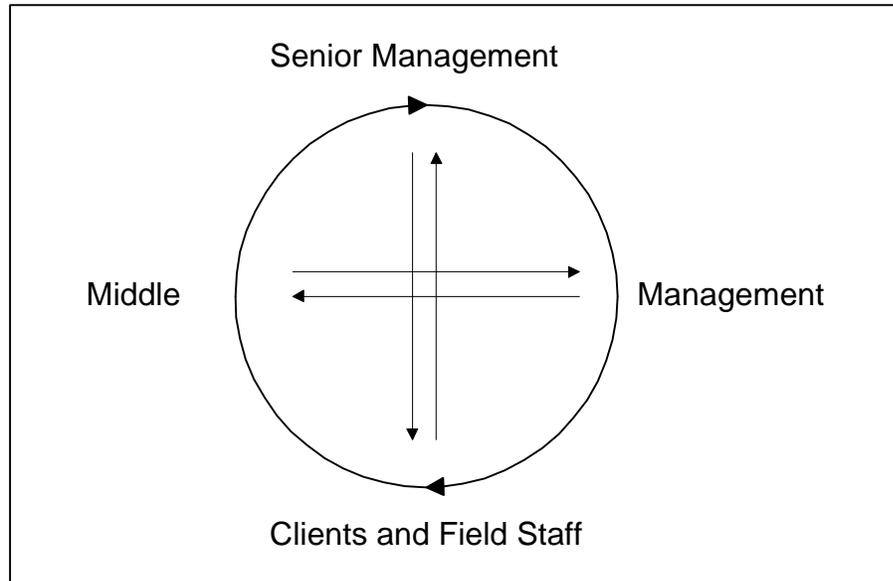
⁸⁹ Harper, pp. 60-62.

⁹⁰ Harper, p. 124.

⁹¹ Hawkins, p. 228.

Communication is a two-way street, and the most important side of the street is usually the less traveled. Listening to key stakeholders is critical. It will help senior management to know if the core values and vision of the firm have been internalized by staff, and to understand the informal culture of the firm. In addition, the perspectives of the stakeholders must be incorporated into the firm's strategy, particularly with regard to understanding the needs of the market.

Figure 6: Information Flow



As shown in Figure 6, information needs to flow through the firm vertically, from head to toe *and* toe to head, and horizontally—the left hand and right hand need to know what each other is doing. In the old type of company, information was power. To manage growth today, information has to be democratized. The more people who know and can interpret, the better. This widens the opportunity to innovate. This is particularly important because field staff usually have a better understanding of customer demands and market trends. They need to be trained to interpret that information, and the communication channels must allow that information to flow up. Access to information also allows employees to participate in the problem-solving process.

A free exchange of information should lead to increased trust between staff and management, and a greater sense of partnership. Access to information increases staff responsibility—once staff have information, they have to do something with it. To facilitate the understanding of information by employees at all levels, companies should rely heavily on the use of graphs and charts to compare current performance with both the target and past achievements.

One of the great challenges is communicating the corporate culture during periods of rapid growth. Most successful high-growth businesses place a premium on celebrating their successes and milestones. They have developed “rituals” that reflect the corporation's key values, and they recognize people who have made major contributions to the firm's success. They may enhance organizational communication through regular meetings that cut horizontally across departments or vertically within

departments. High-growth businesses are likely to have some form of company newsletter that monitors progress toward departmental or organizational objectives, and recognizes individual accomplishments that are in line with the institution's strategy. They also may sponsor social or recreational events for employees and their families.⁹² By including the participation of employees' families, the firm attempts to engender the commitment of the broader corporate family to the culture of the organization.

Quality

The commitment to excellence is a core value that should lay at the heart of growing MFIs. The key to growth in microfinance is portfolio quality. Nothing drives up costs like poor quality. Loan officers who spend their time and travel money chasing down delinquent clients are unable to generate as many new loans, nor are they able to serve their good clients sufficiently. Delinquency undermines the productivity of credit officers and of the portfolio in general. Loan losses begin to erode the firm's capital base. As a result, employees must understand why quality is the organization's top priority.

Collins and Porras' research concludes the following about visionary companies' commitment to excellence:

The critical question asked by a visionary company is not "How can we do well?" or "How well do we have to perform in order to meet the competition?" For these companies, the critical question is "*How can we do better tomorrow than we did today?*" They institutionalize this question as a way of life—a habit of mind and action. Superb execution and performance naturally come to the visionary companies not so much as an end goal, but as the residual result of a never-ending cycle of self-improvement and investment in the future....Visionary companies...attain their extraordinary position...*because of the simple fact that they are terribly demanding of themselves.*⁹³

As long as managers view quality as a dimension that is separate from other dimensions they oversee, like cost reduction and asset turnover, they will miss the whole point. Quality is so intertwined with the whole business process that it cannot be seen as a dimension of a business—it is how the business is defined. Achieving excellence is not a destination—it is a never-ending quest.⁹⁴ "Quality cannot be just 10 percent, 20 percent, or 50 percent better than last year. It has to be perfect or closer to perfect than any competitor can achieve."⁹⁵

MFIs that do not have direct competition need to compete against themselves. Depending on how the company is structured, branches could compete against one another toward the objective of achieving excellence. This approach can be reinforced through the use of rewards and incentives for those who achieve above-average performance. Access to information increases productivity and improves performance. In the absence of feedback, employees often assume they are performing well when they are not.

⁹² Harper, p. 181.

⁹³ Collins and Porras, pp. 187-188.

⁹⁴ Harper, p. 274.

⁹⁵ Boyett and Conn, p. 72.

It is widely believed that whatever is being measured must be important. The regular reporting on performance indicators heightens employee awareness.⁹⁶ Therefore, MFIs need to select their performance indicators carefully. If the MFI wants to emphasize client retention, it needs to measure client retention. If it wants to highlight growth by regularly reporting the number of new clients or new offices, this indicator should be secondary to an emphasis on quality. Otherwise, the firm is likely to experience jeopardizing growth described in Chapter 1. Growth with poor portfolio quality is a death sentence for an MFI.

Another way of generating competition, especially when it does not exist in the local market, is by benchmarking. This is the process of comparing performance indicators to the best in the industry. Benchmarking creates awareness that serves as the basis for change in how the firm does business. When people see what is possible, they usually want to know how the other firms have made the impossible possible.⁹⁷ In microfinance, for example, many loan officers have not maximized their productivity. If loan officers handle case loads of 100 to 150 clients, how would the loan officers react if they learned that loan officers at BRI Unit Desa in Indonesia and Los Andes in Bolivia manage high-quality portfolios with 400 to 500 clients using individual lending methodology? Benchmarking may challenge them to find ways of increasing their productivity.

Customer Service

In any service industry, one core value that has to be retained is the commitment to customer service. In microfinance, providing excellent customer service is even more critical than in other service sectors. MFIs must retain their best clients because their larger loan sizes and the familiar relationship make it possible for the organization to balance outreach and sustainability. As the institution grows, it will retain its commitment to its customers only if customer service is a critical component of the corporate culture.

Sam Walton captured the essence of Wal-Mart's number one core value:

We put the customer ahead of everything else....If you're not serving the customer, or supporting the folks who do, then we don't need you....We exist to provide value to our customers—to make their lives better via lower prices and greater selection; all else is secondary.⁹⁸

Customer responsiveness begins with a commitment by the business to a life-long relationship with each customer. For this to be possible, the firm must have a long-term outlook. Many MFIs, living from one two-year donor contract to the next, are unable to assume the long-term vision that quality customer service requires—this is yet another reason why MFIs have to be committed to financial self-sufficiency.

Businesses that provide excellent service see themselves as customer problem solvers. In microfinance, for example, the institution should not see itself as a business that provides financial services to low-income communities, but as a solver of the problems of its customers by providing financial services. The difference is more than semantic. It reflects the culture of the business. If the

⁹⁶ Boyett and Conn, pp. 49-54.

⁹⁷ Harper, p. 280.

⁹⁸ Collins and Porras, pp. 70, 74.

firm sees itself as a customer problem solver, it will go out of its way to ensure that its products are indeed achieving that objective. A customer problem solver views the world in general, and more specifically the business, through the customers eyes, and it recognizes the changing needs of the customer.⁹⁹

Repeat customers are not necessarily satisfied customers. Retention should not be confused with loyalty. This is especially true for MFIs that operate in monopoly markets. It is easy for a high-growth business to take its current clients for granted. Its efforts to attract and serve new customers may overshadow the need to provide first-class service to customers. The price of the product may get the customer's attention, and it may even result in a sale, but lasting business relationships are built on quality service, trust, dependability, and responsiveness.¹⁰⁰

Customer service research has determined that it takes five times more money to find a new customer than to retain a present one.¹⁰¹ Customers who had a bad experience with a firm usually tells at least nine other potential or existing customers. Research also has indicated that 96 percent of a company's dissatisfied customers never complain to company, but they tell a lot of other people.¹⁰² It is cheaper to invest in customer service and in resolving customer complaints than to invest in attracting new customers.

Customer service is even more crucial for MFIs than in other types of businesses for several reasons:

Word of Mouth Marketing. Most MFIs rely on word of mouth as their primary means of attracting new clients. Bad news travels faster than good news. If their active clients are not receiving appropriate service, the MFI will find it even harder to attract new clients who are appropriate risks.

Initial Loans Are Subsidized. It is expensive to administer a portfolio that consists of thousands of very small loans. In most MFIs, first-time borrowers, with their very small loan sizes, are subsidized by repeat clients. Another way of considering this issue is that an MFI does not earn money on a client until the client has borrowed two or even three times. By retaining repeat clients, the institution can amortize the high cost of acquiring new clients over a longer period of time. The MFI has little control over clients who drop out because their businesses are poor or who are kicked out because they have a bad repayment record, but it can ensure that it does not lose clients because it did not provide good customer service.

Initial Loans Are Expensive. The target market for microfinance may require more assistance than customers in other businesses. Because new borrowers are often unfamiliar with the process of accessing business loans, the cultivation of new clients in microfinance is particularly time consuming and expensive.

Repeat Clients Are Better. For MFIs, repeat clients are supposedly, although not always, less risky and less labor intensive than new clients. As a result, loan officers who retain

⁹⁹ Harper, pp. 265-267.

¹⁰⁰ Harper, pp. 253-254.

¹⁰¹ Harper, p. 260.

¹⁰² Boyett and Conn, p. 12.

repeat clients should be able to manage larger case loads than staff with new portfolios, and therefore be more productive.

Social Mission. One microloan is not going to solve the financial problems of a low-income household. By providing customers with long-term access to financial services, MFIs are able to assist them to accumulate capital to break the vicious cycle of poverty. For MFIs to fulfill their social mission, they need to retain their clients.

The bottom line is *growth begins with customer retention*. For MFIs to grow, they need to keep their present customers *and* attract new ones. Both the keeping and the attracting will be easier if the MFI provides excellent customer service. Depending on the firm's growth strategy, growth could include increasing the depth of the relationship with each customer by cross-selling products where appropriate, as well as increasing the number of customers.

If customer service is a priority—and it should be—the company needs to monitor performance and reward it. Customer service is more than an incentive program or a catchy slogan. Customer service is an attitude; as such, it is difficult to measure. The retention of repeat clients, although a useful indicator, does not provide information about why clients stopped borrowing from the institution or how they feel about the service. To assess these qualitative aspects of customer service, businesses try a variety of approaches such as:

- **Mystery Customer Program.** The business organizes with outside agents to monitor customer service by acting as prospective customers and secretly evaluating the quality of the service that is provided. It is important that the feedback from the mystery customer evaluation be used constructively so staff can learn how to provide better customer service. This may help staff understand that they never get a second chance to make a first impression.
- **Customer Advisory Boards.** Offices could have customer advisory boards, consisting of current or previous clients, that regularly review the service of the branch and report their findings to both the branch and head offices.
- **Customer Lunches.** To solicit customer views, senior management can organize an annual lunch in each branch with a representative sample of clients. In this forum, it is important not only to listen to customer comments and criticisms, but also to respond to them in tangible ways.
- **Focus Groups.** Research firms can conduct focus group sessions with representative samples of clients to evaluate customer service. The approach is conducted anonymously by external agents, and therefore customers may be more willing to be critical. Focus groups could also include prospective clients and the competitors' customers to determine why they are not your clients.
- **Client Surveys.** Surveys of larger samples can be used to quantify customer service and to solicit ways of improving service. This approach is particularly informative if it focuses on former clients, to learn why they stopped borrowing from the organization.

Regardless of the approaches taken, customer complaints need to be solicited and rewarded. Every complaint should be seen as a suggestion how the firm can improve its competitive position rather than as an attack. Why should the firm pay expensive consultants to identify areas where the

business can be improved when customers' complaints and suggestions often identify the same areas? Customers are an excellent source for new ideas and innovations.¹⁰³

A well-handled problem can generate more loyalty than existed before the incident. To handle the problem effectively, the business must avoid being defensive.¹⁰⁴ To ensure that the customer service ethic is pervasive throughout the company, the chief executive officer should even handle some complaints personally. Xerox keeps its head office executives in touch with customer needs by designating each, in turn, as officer of the day to answer complaints.¹⁰⁵

Customer service begins at the top. Alfred P. Sloan built General Motors into the world's premier manufacturing company in the 1920s and 1930s by actually working with customers. Once every three months, he would disappear from Detroit without telling anyone where he was going. The next morning he would show up at a dealer's lot and ask permission to work as a salesman for a few days. After two or three similar stops that week, he would go back to Detroit and fire off memoranda on changing customer behavior and preferences, on customer service, on company service to the dealerships, and on market and style trends.¹⁰⁶

All staff must make it their responsibility to step out of the office on a regular basis and talk to customers. And not just to their customers, but also to their competitor's customers, their former customers, and their potential customers who are not receiving services at all. This approach is not unfamiliar to microfinance. The founding managing director of BancoSol regularly spent days in branches working as a teller to keep in touch with customers' demands and to ensure that the services provided by the main office were meeting the needs of the branches.

The most successful firms, particularly in the service industry, realize there is a direct relationship between customer relations and employee relations. If management cuts corners with its employees, the employees will cut corners with customer service. Employees attitudes toward customers reflect their treatment by their employers. They cannot serve unless being served. There is no way to instill a positive customer service ethic before the business embodies a positive employee ethic. Employees must be empowered to do whatever is necessary to help an upset customer feel good about his or her relationship with the company.¹⁰⁷

The importance of customer service and practical ways of achieving it must be reiterated again and again throughout the employee's tenure with the organization, from the initial interview, through orientation and training, and in ongoing training. Customer service should be built in to the performance review process, and employees should be rewarded for providing excellent customer service. Some businesses even solicit their customers' views as a part of the performance appraisal process.

As discussed in detail in the following chapter, employees cannot be motivated if the obstacles that impede their ability to perform their duties are not removed. Customer service provides a good example. Loan officers cannot provide excellent customer service if disbursements are not available when they are promised or if the loan officers cannot determine the account balance because the

¹⁰³ Harper, p. 265.

¹⁰⁴ Harper, p. 265.

¹⁰⁵ Tomasko, *Go For Growth*, p. 100.

¹⁰⁶ Drucker.

¹⁰⁷ Hawkins, p. 198.

computer has crashed. Customer service is equally as important with internal customers as it is for external customers. In the bottom-up view of the organization, employees who provide support services to the branches, such as staff training, computer technical assistance, or human resources, must realize that their *raison d'être* is to provide the best possible service to the branches to enable them to provide the best possible service to the customers. Often employees forget that customers, either internal or external, are not an interruption of their work, they are the purpose of it.

One challenge for new loan officers is how to combine a passion for customer service with strict delinquency management. Employees need to realize these are not contradictory. In fact, by being strict with customers who are late with their repayments, loan officers are actually doing them a favor. If a strict delinquency management approach results in timely repayments, the loan officer is helping clients avoid generating a poor credit history and providing them with the discipline that their business needs in order to grow.

Innovation

Closely associated with customer service is the importance of innovation and adaptability. What worked well for the company yesterday may be less effective today and obsolete tomorrow. Growing businesses need to innovate and adapt constantly to meet the changing needs of their clients and to keep one step ahead of the competition.

Many large businesses are now trying to act like emerging businesses. It was not long ago that emerging firms wanted to operate like Fortune 500 firms. Today, more and more Fortune 500 firms are adopting “corporate entrepreneurship” in their strategies and cultures so they can be more opportunistic and agile. In its effort to be large *and* entrepreneurial, 3M strives to have 25 percent of the firm’s sales five years from now from products that do not exist today. The firm’s culture rewards innovation and unconventional thinking.¹⁰⁸ Merck, the pharmaceuticals company, embraced a strategy of consciously yielding market share as products became low-margin commodities, thus forcing itself to innovate in order to grow.¹⁰⁹

Businesses with venturesome or entrepreneurial cultures tend to be very adaptive. In growing firms, people at all levels are accustomed to doing things they have never done before. They take pride in their ability to rise to the occasion. To be innovative, management should realize that every employee is a source of ideas, not just a pair of hands. Growing businesses have too few people to begin with, and they cannot afford not to capitalize on the full potential of each employee. Some businesses expect one new idea per employee per month.

To solicit employee input, Hawkins describes a participatory process he calls “Go for Broke.” Once a year, everyone in the firm lists everything in the company they think is broken and needs to be fixed. This produces a company-wide inventory of what needs to be noticed, changed, improved, or checked, including relationships between employees. The winners of the most original, humorous, and best conceived “Go for Broke” receive awards, such as an all-expense paid weekend at a resort. But the process must not end there. The key to this exercise is not soliciting input, but responding to it.¹¹⁰

¹⁰⁸ Harper, p. 171.

¹⁰⁹ Collins and Porras, p. 188.

¹¹⁰ Hawkins, pp. 223-226.

Some employees will suggest better ways of doing what the firm already does, but some suggestions be ideas for new products or new markets.

Growing MFIs need to be learning institutions that are committed to research and development. For MFIs, research has historically meant conducting donor-driven impact studies to provide quantitative evidence to demonstrate that the institution is fulfilling the political objectives of that stakeholder. Today, microfinance needs to move away from impact studies toward research that is meaningful for the institution, such as research on the appropriateness of its products, market research for future products, and assessment of the quality of its customer service.

For a growing business to continue growing, it has to be a learning organization that monitors the market and scans the horizon looking for clues or trends. It needs to be proactive by regularly analyzing how can it can do better.¹¹¹ There may be a tendency in mature MFIs to assume that, because their current financial products are so successful, they should continue to operate the way they are and just increase the scale of their operations. But the “if it ain’t broke, don’t fix it” philosophy does not work in business. Successful firms are constantly innovating and upgrading, and they spend a significant percentage of their budget on research and development.

Hawkins believes that a major problem affecting businesses, large or small, is a lack of imagination. A ready supply of money in start-up firms tends to replace creativity. Companies with money buy solutions, such as hiring consultants, lawyers, clever accountants, publicity agents and marketing studies. Companies without money dream and imagine, and are better prepared to innovate their way into strong positions in the market.¹¹² Donor organizations should consider how their resources may undermine the imagination of an MFI.

Drucker outlines three different types of research that are applicable to microfinance:

- (1) **Improvement** - making the already successful products better still in the never-ending quest to register improvements in cost, quality, and customer satisfaction;
- (2) **Managed Evolution** – using each successful new product as the stepping stone to the next one; and
- (3) **Innovation** – systematically using changes in society and the economy, and in demographics and technology, to produce completely original products.

Innovation is not always successful. Business history is littered with flops that cost companies like Ford, IBM, and Polaroid millions of dollars. In the United States, one in 10 research and development projects is commercially successful, and only 56 percent of the new products that were introduced during the 1980s and early 1990s were still on the market after five years.¹¹³

MFIs do not have deep enough pockets to afford expensive mistakes. Each new product adds to the complexity and costs, which increase the challenges of operating in an already difficult market. CorpoSol’s experience of unsuccessfully introducing products provides an example of the vulnerability of MFIs. Lessons from failed efforts to innovate in microfinance suggest that the timing of product

¹¹¹ Harper, p. 65.

¹¹² Hawkins, p. 33.

¹¹³ Boyett with Boyett, pp. 2-3.

introduction is critical. MFIs should first specialize and succeed before they begin to add new products, and even then the addition of innovative products should be very deliberate.

MFIs need to find ways to improve the odds of success without shying away from entering uncharted waters. All new products must be thoroughly researched and pilot tested, and they must be designed with the customer in mind. The greatest challenge in microfinance product development is to balance the need for customizing products to customers' specifications with the necessity of making the products generic enough for a large market, while minimizing risk. This challenge is compounded by the potential limitations of field staff and the information system. Growing MFIs, which are committed to constant improvement, must ensure that they hire adaptable staff who are prepared for ongoing change.

For MFIs that started as non-profit institutions and later created formal financial institutions, one approach to minimizing the costs of research and development has been to allow the NGO to operate as a research and development unit funded in part by grants. This approach could even be used by commercial banks that want to enter or extend their reach in the micro market.

Honesty

Although this aspect of institutional culture is not discussed at length in the literature, honesty is a critical cultural characteristic in microfinance—particularly in a growing MFI. In small institutions, it is easy for senior managers to ensure that staff are honest and trustworthy. As the MFI grows and becomes decentralized, senior management has find other means to monitor the moral integrity of its staff. Fraud prevention strategies usually focus on internal control procedures and the use of internal auditors. However, for MFIs the most effective means of deterring fraud may be actively integrating honesty into their institutional culture.

As with other aspects of institutional culture, inculcating honesty begins before an employee is hired. From the interview to orientation to ongoing staff training, MFIs must constantly highlight that honesty and trust are the fulcrums on which all their business relationships rest. Microfinance will succeed only if three bonds of trust remain intact: if loan officers trust one another, if clients and loan officers trust each other, and if loan officers and management trust each other. If any of these bonds of trust is broken, the institution may experience irreparable damage, which ultimately hurts the field staff and the client the most. Fraud in microfinance amounts to stealing from colleagues and stealing from low-income persons, and can undermine both the social and the financial objectives of the business. As a result, it is everyone's responsibility to protect the institution from fraud, not just managers and internal auditors. MFIs that are able to incorporate this thinking into their institutional culture create peer pressure, which may be a more effective deterrent than a host of internal control procedures.

One type of fraud involves kickbacks or bribes to loan officers in exchange or as a condition for loans. Loan officers must understand the importance of not accepting customer favors in order to uphold the integrity and transparency of the client-staff relationship. To ensure that this issue became a part of BancoSol's culture, in training and workshop settings staff repeated the mantra "not even a glass of water" to indicate they would not accept any favors from their clients.

Culture and Institutional Transformation

If the institution transforms from an NGO into regulated financial intermediary, what effect does the institutional type have on the institutional culture? When a non-profit organization becomes for-profit, some of its external relationships will invariably change. For example, the business will focus on public relations instead of fund raising; it will attract investors instead of donors; it will emphasize market research rather than impact studies. However, if the new MFI retains the same values as its parent NGO, the change of institutional type should not necessitate a change in the relationship with the clientele.

Defining and promulgating institutional culture are two of the more significant challenges involved in the transformation process. The employees of the new MFI have to retain their commitment to the development mission *and* adopt values that are appropriate to the private sector. For employees that joined the organization because of its social agenda, they need to be convinced that the private sector orientation is not in conflict with the social mission. At the same time, the creation of a regulated financial institution requires more sophisticated financial skills, which will likely require the addition of staff with banking expertise. Because these new staff members probably have different values than the original employees of the NGO, the institution will have to invest heavily in team-building exercises to forge relationships between the old and the new staff.

The external aspect of the institutional culture must also be considered. The corporate image as perceived from the outside is as important as how the institution perceives itself. In microfinance, many clients feel comfortable with MFIs largely because they are not banks. If they create a formal financial institution, MFIs must protect against formalizing to the extent that they will alienate their client base. This is particularly true as they introduce measures to comply with the security regulations of the formal financial sector. Transforming MFIs need to educate their clients, to explain that the changes are taking place so that the institution can serve them better, and to solicit customer feedback if they feel they are not receiving better services.

CHAPTER 3: HUMAN RESOURCE DEVELOPMENT

The foundation of any MFI is the interaction between the institution and its customers. This bottom-up view of the institution appropriately emphasizes the critical role of field staff as the foundation of microfinance, and places human resource development as a top priority for managing growth. If the firm places a premium on its people, it needs to create an atmosphere that makes the firm the best possible employer to the people it wants to attract and keep.¹¹⁴ Since non-profit organizations are typically constrained by limited resources, they have to be particularly innovative in hiring and retaining quality staff.

Firms will grow only to the extent that they have the right number of people in the right place at the right time with the right capabilities. Service firms, like MFIs, are particularly vulnerable to the consequences of short-changing the people side of the business. In the service sector, the firm's employees are its products—if the firm does not have the right number and type of employees, it runs the danger of being out of stock.¹¹⁵

Businesses that grow too fast or in the wrong way overwhelm the adaptive capacity of the people who work there—the company outstrips the employees' ability to learn and develop. Employees should be prepared for growth. Management needs to communicate where the business is going and how it might affect staff, and then find out what they think about that scenario—how they feel growth will affect their jobs and whether they think the business can handle the rapid hiring and training of new people. Employees are often closer than managers to the problems associated with rapid growth. They see and feel the strain and the weak points, and they can identify these areas of vulnerability.¹¹⁶

This chapter focuses on human resource issues, such as hiring, training, and motivating staff, within the context of a growing institution. In doing so, it emphasizes the importance for a growing firm to invest in its employees so they can grow in parallel with the business. It also shows the role of field staff in managing growth at the branch level, and introduces some new thinking on middle management in microfinance.

Hiring

Human resource management begins with human resource planning. The business plan will indicate the projected structure of the business and the number and nature of the positions. In addition to hiring for growth, the firm also has to hire for attrition.

Minimizing staff turnover is critical for growing companies. The firm is hiring so many new people already, it risks losing its corporate history and culture if it loses too many “old hands.” Just as MFIs want to retain repeat borrowers, no company wants to lose well-performing, experienced staff members, especially after they have invested thousands of dollars in training that person. If employees are leaving to work for a competitor, the firm is in effect subsidizing the training costs of its

¹¹⁴ Harper, p. 180.

¹¹⁵ Harper, p. 204

¹¹⁶ Hawkins, p. 222.

competition. Staff turnover is also an indication that a firm does not respect its employees or treat them well.

Growing companies should try to attract and retain people who will make growth possible, not just hire people to fill vacancies. This can be achieved only if the firm is considered the employer of choice by prospective and present employees. A growing company should hire people with specific traits and abilities that are compatible with the corporate culture, and then provide training to teach them specific skills.¹¹⁷

The best way to avoid firing people is to hire the right people in the first place. This may seem obvious, but in the rush to hire employees a growing firm may not screen prospective staff members properly. Growing businesses need to employ screening procedures regardless of the pressure to hire, because hiring in haste invariably results in hiring the wrong person. The people who will work with the new employee should have the main voice in the hiring decision. For example, all branch staff should be involved in the hiring of new loan officers. This is especially important if the MFI relies on teamwork and group-based incentives because the chemistry between team members helps determine the relative success of the team.¹¹⁸

Employees need an opportunity to contribute to and grow with a growing company. The number one priority should be to attract, retain, and motivate quality people.¹¹⁹ Hawkins suggests that the best source of new employees is a satisfied worker.¹²⁰ The satisfied worker presumably understands the corporate culture and will know people who are and are not good fits. A satisfied employee can also make a stronger sell to prospective staff person than a human resource specialist who may not fully understand the intangible benefits of working at the field level. Some companies actively encourage peer recruiting by paying incentives to employees who bring in new staff after the new hire completes the probation period.

Growing companies face the perpetual dilemma of when to hire new staff. Should they add new staff to generate new business, or should they cultivate the demand before creating the capacity to fulfill it? Neither of these choices is ideal, and the answer will depend on the financial situation of the institution and its projected growth pattern.

MFIs that have the capacity—including a proven lending methodology, a well-managed staff training program, an effective information system, access to large chunks of loan capital, and the administrative capacity to process volumes of applications efficiently—are probably ready to hire waves of new field staff in anticipation of demand and achieve economies of scale in training. But if any of these pieces is not in place, the MFI is likely to experience premature growth if it adds new field staff too quickly.

Hawkins believes that a growing company will be healthier if it remains slightly understaffed. Most companies are overstaffed with too many people for the work available. Employees sense their redundancy. They know they are not fully utilized, and their natural reaction is to protect the work that they have. They become territorial. One manifestation of territoriality is to share information unequally, particularly not with people under them. The slightly understaffed company, however,

¹¹⁷ Harper, pp. 205-209.

¹¹⁸ The use of teams as a building block for MFIs is discussed in the next chapter.

¹¹⁹ Harper, Chapter 14.

¹²⁰ Hawkins, p. 220.

avoids this danger because people need one another more. With too much work to do, people are more willing to share work and responsibility. In general, people would rather be over-utilized than underworked. One is challenge, the other is boredom.¹²¹

MFIs may also choose to remain slightly understaffed to moderate their growth rate. This defensive approach to growth is appropriate if the firm does not have the capacity to cope with significantly higher volumes—as is the case with most MFIs in the world. The challenge to understaffing the business is to avoid burnout from overwork. Managers need to stay in touch with their employees and strike the right balance.

If the firm's growth pattern involves opening new offices, it is strongly recommended that MFIs do not staff new branches with new personnel. Unfortunately, MFIs often open new branches with green employees. First impressions are so critical that MFI should consider deploying their most accomplished field staff to get new offices up and running. Successful MFIs have developed two methods of starting new offices with experienced staff: the amoeba approach and the new branch experts. In the amoeba approach, once a branch reaches a certain scale, it is split into two offices responsible for separate geographic areas. With new branch experts, the MFI uses a team of people who specialize in opening new offices and in training new staff and managers.

Orienting and Training

The addition of new staff must meet with the institution's ability to train and deploy human resources. An expanding institution requires systems to produce a large volume of well-trained front-line staff. Following the principles of standardization, the most recently hired staff must employ the same methodology as the first. Staff training is an ongoing process throughout the entire relationship between the employee and the firm.

The firm needs to orient new employees to its vision, strategy, and culture. When the orientation is done properly, new employees sense the unique nature of the business and what makes it tick. The orientation is not just designed to inform new employees where the bathrooms are or when payday is—the orientation should strive to ensure that new staff understand the firm, what it does and how it does it, and get new employees to buy into the firm psychologically. The most successful firms thoroughly indoctrinate employees into the core ideology of the company, creating cultures so strong that they are almost cult-like. This includes creating a sense of elitism so that new employees feel they are joining something that is special and superior.¹²²

In a rapidly growing business, where an increasing percentage of employees are new to the firm, orientation plays a critical role in promoting and sustaining the institutional culture. If employees cannot buy into the unique and special nature of the company, they should leave. At Disney, for example, if you do not embrace the idea of “wholesomeness” and “magic” and “Pixie dust,” and make yourself into a “clean-cut zealot,” you probably should not work at Disneyland.¹²³ The most successful businesses ensure a tight fit between the employees' values and the corporate ideology.

¹²¹ Hawkins, pp. 227-228.

¹²² Collins and Porras, p. 71.

¹²³ Collins and Porras, p. 121.

Harper suggests that the chief executive officer should participate in the orientation session for new employees, to welcome them to the firm, to share with new staff the chief executive officer's vision for the business, and to indicate how they will benefit if they are committed to making that vision a reality.¹²⁴ Tomasko states that firms invest in growth by investing in people—the more people there are in the company who can imagine what it can become, the more likely it is to get there. New employee orientation is just the first step in aligning corporate and employee values and objectives.¹²⁵

Initial staff training usually includes two components: classroom training for groups of new recruits and on-the-job training. During the classroom phase, new recruits receive an overview perspective of the organization and see how their roles fit into the bigger picture. This setting is used to indoctrinate new employees into the core values of the business, such as a commitment to quality and customer service, and to teach them the theoretical aspects of their jobs. Much of the training curriculum will depend on the organizational structure. For example, if the business is organized around teams or groups of employees, it will be necessary to teach interpersonal and problem-solving skills. If the organization relies on the self-management of front-line staff, new staff will also be taught how to read and interpret performance indicator reports.

The on-the-job phase, which may last several months, allows new staff to learn the technical aspects of the job and the tricks of the trade from experienced personnel. In microfinance, many of the skills of field staff, such as client selection and delinquency management, can be learned best through experience. In many MFIs, it is often expected that new staff will make mistakes, and learn the hard way about to whom not to lend and what arguments and methods are effective in convincing delinquent clients to repay their loans. However, if the on-the-job training is properly organized and sufficient in duration, new recruits can learn many of the nuances of microlending without having to make mistakes. Unfortunately, in the rush to make new staff productive, perhaps because of poor planning at the outset, MFIs may limit the on-the-job training to one or two weeks. It is not likely that new staff can develop healthy portfolios after such short exposure.

In a growing business, staff training does not end after these initial phases. Ongoing training is required to help employees grow as business grows. This involves planning to identify the new skills that employees need to fulfill personal and corporate objectives. Training in growing companies often involves cross-training so people can perform a variety of jobs. This reduces the business' vulnerability to absenteeism and attrition, and creates flexibility. Cross-training can also enhance the ability of staff to participate meaningfully in redesigning work procedures to accommodate growth because employees can see the work environment from various perspectives.¹²⁶ In microfinance, cross-training at the branch level would mean that field staff would learn to perform multiple functions, and therefore be more valuable employees. For example, if loan officers specialize in delivering specific products, once they perfect the provision of one product they learn how to deliver another product.

Some companies plan the regular rotation of key employees throughout the organization to spread new techniques and to understand different perspectives.¹²⁷ In microfinance, staff rotation can facilitate the transfer of innovations between branches and assist in preventing fraud. It is important to

¹²⁴ Harper, pp. 178, 210.

¹²⁵ Tomasko, *Go For Growth*, p. 243.

¹²⁶ Harper, p. 210.

¹²⁷ Tomasko, *Go For Growth*, p. 244.

the success of microfinance for loan officers to build long-term relationships with their clients. This relationship improves the quality of business assessment and has a positive effect on delinquency management. However, a tight relationship between loan officers and their clients also makes MFIs vulnerable to staff turnover and fraud. Some MFIs rotate loan officers' portfolios within an office every two years to reduce fraud risk. Other MFIs rotate loan officers between offices to transfer lessons and innovations.

Motivating

A growing MFI must have the capacity to manage and motivate new staff. Incentives are an important aspect of staff development. Salaries often represent the largest percentage of an MFI's fixed costs. To achieve financial viability, the MFI must keep these costs in check. To achieve outreach, however, staff need to be appropriately rewarded for their efforts. Managing growth involves identifying the right mixture of monetary and non-monetary incentives, including base salary, individual- and/or group-based rewards, staff development opportunities, benefits, the possibility of developing new skills, and the intangible benefits derived from the institution's development mission.

Since MFIs usually do not have resources to pay their employees top dollar, they need to develop creative ways of attracting and retaining strong staff members. The sections below review the importance of financial compensation and non-financial rewards in motivating the personnel of a growing company, and the roles of performance appraisals and goal setting in human resource development.

Compensation

The traditional approach to compensation encourages people to do what was in their job descriptions, but not what was best for the company. Typically, employees are paid based on their position in the corporate hierarchy, their level of responsibility, and the number of people who report to them. This approach actually rewards additional overhead and higher costs.¹²⁸ A growing MFI, which needs to keep a tight rein on costs, should consider alternative ways of rewarding staff.

If the MFI assumes a flatter organizational structure, there will be fewer promotional opportunities. In a lean organization—one that has fewer layers of bureaucracy and is committed to keeping costs low—alternative compensation approaches are critical. Some of the following alternative approaches could be considered:¹²⁹

- **Performance incentives**, for individuals and/or groups, comprising on average between 50 and 100 percent of an employee's total income;
- **Pay for knowledge** or skill level, rather than bureaucracy level; under this approach, instead of increasing salaries by promoting people to new positions, employees have the opportunity to increase their base pay by learning to perform a variety of jobs; this directly encourages employees to be more flexible;

¹²⁸ Boyett and Conn, p. 116.

¹²⁹ Boyett and Conn, pp. 135-140.

- ***Profit-sharing or employee stock options***: employees who enhance their company's competitiveness and make a direct contribution to profit should be rewarded in kind; this approach gives employees an interest in the success of the company, reduces turnover, and increases staff productivity; and
- ***Gain sharing***, a group-based incentive program in which employees earn bonuses by finding ways to save the company money in labor, capital, materials, and energy; the company splits the savings with the employees, usually 50-50.

To emphasize performance, many growing businesses are reducing, or even eliminating, annual increases in base pay and increasing performance incentives as a percentage of total compensation. Drucker suggests that the firm should compensate all personnel based on performance rather than rank. This could even result in front-line staff earning more money than their supervisors.¹³⁰

An example of revolutionary compensation approach is Lincoln Electric, a medium-sized manufacturing company in Ohio. It is the world's lowest-cost producer of welding machines, yet its productivity is as much as 250 percent above the industry's average in most years. Lincoln employees receive no company-paid benefits, no paid holidays, and no sick leave. In fact, production employees receive no base salary or hourly wage at all. These employees are paid based upon what they produce either individually or as members of small work groups. The more employees produce, the more they make.¹³¹

Alternative compensation approaches are not just about money. A company that shares profits should also be willing to share responsibility, authority, praise, credit, and a good joke. Money is never a substitute for esteem, pride, and dignity. Profit sharing without a sense of sharing is nothing but piecework.¹³²

The purpose of incentives is to induce decision makers to promote the interests of the organization by encouraging behavior that would not occur in the absence of those incentives, including the decision to work harder. The structure of incentives should be designed to ensure that the resulting increases in productivity more than match the increases in costs. Not all incentives are equally relevant or effective.¹³³ Incentives and rewards do not always reinforce behavior that is in accord with the growth strategies and vision of the organization. Tomasko suggests that a growing firm needs to evaluate the various incentives and rewards that it uses by considering the following questions:¹³⁴

- To what are incentives actually encouraging people to pay attention?
- What are they actually encouraging people to do?
- What actions will growth require from employees and managers that are not currently happening?

¹³⁰ Drucker, p. 161.

¹³¹ Boyett and Conn, pp. 119-120

¹³² Hawkins, p. 115.

¹³³ This insight was provided by Claudio Gonzalez-Vega. For a thorough analysis of staff incentive schemes in microfinance, see the Katherine Stearns, "Monetary Incentive Schemes for Staff," GEMINI Technical Note #5 (Washington, D.C.: ACCION International, 1993).

¹³⁴ Tomasko, *Go For Growth*, p. 238.

What should microfinance employees be rewarded for? Excellent portfolio quality, high productivity, client retention, customer service, and branch profitability spring to mind. In a growing MFI, performance incentives should be used as a growth management tool. It is logical to use a combination of individual and group incentives for field staff, to reinforce a loan officers accountability for a specific set of clients and to reward staff for their efforts to assist one another to achieve objectives of the branch.

Non-financial Rewards

In a growing business, it is necessary to create and manage an environment that brings out the best in its employees because the firm cannot afford all the people it needs, and it will not be able to hire the best people in the world. People are not only motivated by their paychecks. Employees may be also interested in challenging work, recognition, an opportunity to manage themselves, an opportunity to participate in corporate decision making, promotional opportunities, and professional growth.¹³⁵

Non-financial rewards, such as increased responsibilities and professional growth, benefit both the employer and employee. To provide the organization with strength and flexibility, the staff need to be both strong and flexible. For that to be possible, their jobs have to have substance and content. This can be accomplished by leveraging senior talent with that of juniors. Frequently, 50 to 75 percent of the work time of expensive talent is spent on activities that they do not need to do, whereas junior personnel are often underutilized. By adding depth to the work of junior staff, senior staff are freed to do the work for which they get paid higher salaries; and this contributes to the development of in-house leadership.

Flexibility allows one individual, through cross-training, to perform more than one job. This allows staff to be moved around based on changing demands. It improves customer service because the person who fields a request or complaint can respond immediately, rather than referring the customer to someone who specializes. And, most important, it improves the work content for both senior and junior staff.¹³⁶

Incentives systems usually provide monetary rewards for achieving certain performance criteria, but very rarely do they involve non-financial rewards. In addition to creating strength and flexibility by cross-training and reassessing job descriptions, non-financial rewards could include a day-off voucher, an employee of the month salute, or a weekend away for two. Incentives that directly benefit employees' families are especially powerful because they reward families for the sacrifices they make, in the form of an absent spouse or parent, on behalf of the business. The only limit is one's imagination in designing innovative ways to reward and motivate employees.¹³⁷

In a smaller business, senior management can personally demonstrate a genuine concern for the employees, but as the business grows, the direct link between the managing director and the loan officers weakens. Senior management needs to find ways of maintaining that personal link to motivate staff to perform to the best of their ability. Some companies do this by organizing breakfast with the

¹³⁵ Harper, p. 240

¹³⁶ Tomasko, *Rethinking the Corporation*, pp. 81-88.

¹³⁷ Harper, pp. 240-244.

boss so every employee has the ear of the chief executive officer at least once a year.¹³⁸ Successful and expanding MFIs recognize the motivating influence top management can have on its field staff. At Accion Comunitaria del Peru, for example, every month the managing director takes the employees of the best branch out to lunch at a fancy restaurant.

If managers want to bring out the best in their people, they need to avoid treating everyone alike. What is a reward to one person may be of little value to the second person, and a punishment to a third. In addition to recognizing their differences, employers need to consider how rewarding one employee will affect others. Employees interests also change over time. Young, single employees may be willing to concede financial rewards for the opportunity to assume greater responsibilities, but if they start a family or buy a house they are likely to require higher pay. Through the performance evaluation process and other mechanisms, employers need to ensure they regularly learn what their staff members want from their jobs.¹³⁹

In the past, managers tried to improve performance by motivating employees to work harder. Managers frequently blamed organizational ills on the lack of employee motivation. The new approach is based on the premise that employees already recognize that they have a vested interest in the firm's performance. Following this assumption, employees should work on problem-solving teams to correct things that impede high levels of performance. Managers should serve as facilitators and resource providers rather than bosses and controllers.¹⁴⁰

One way to motivate employees is to develop a corporate culture that gives the workplace greater meaning. Boyett and Conn suggest some ways of achieving this:¹⁴¹

- Create an environment where all employees feel that they can make a difference;
- Give staff a special mission so that work is more than an economic exchange;
- Empower people through involvement, where managers act as facilitators who remove obstacles;
- Be open and frank about the company's business strategies—make sure all employees know everything;
- Trust people to do the right thing—given information and self-control, people will act in the best interests of the company, which is also in their best interests;
- Create a unique culture and indoctrinate people from the start in that culture; and
- Make sure people know how to behave consistent with the corporate vision, and reward people who do.

Because of the unique mission of microfinance—to help people to help themselves—MFIs should be able to create an environment in which employees feel that they can make a difference. However, some MFIs have problems with staff turnover, indicating that there are greener pastures in

¹³⁸ Harper, p. 228.

¹³⁹ Harper, Chapter 16; performance appraisals are addressed in more detail later in this chapter.

¹⁴⁰ Boyett and Conn, pp. 83-86.

¹⁴¹ Boyett and Conn, pp. 113-114.

the market. Can staff attrition be reduced by offering a more competitive employee package, including both financial and non-financial rewards? MFIs need to ensure that their salary packages are competitive, in both the development and the finance markets, to minimize staff turnover. If, for financial reasons, an MFI is unable to offer a competitive financial package, it should heighten the use of the non-financial rewards. However, as institutions grow, MFIs will need to find resources to become competitive employers. In the past, there was an impression that, because MFIs pursue altruistic objectives, their staff should work for less than the value of their effort. This was a mistake. The organizations that reward their staff in market terms attract better employees and are more successful.

Performance Appraisals and Goal Setting

Another method for motivating staff to improve their performance is through the performance appraisal process. Traditionally, supervisors sit with their employees on an annual or semi-annual basis to review the employee's performance during that period against the objectives set during the previous performance appraisal. Then the supervisor and employee prepare objectives for the following period. Typically, the performance appraisal process is directly linked with annual salary increases. But for growing businesses, the performance appraisal process needs to be reconsidered.

Performance appraisal does not have to just be a top-down process. General Electric involves customers and suppliers to help evaluate the performance of work groups, creating a 360° performance appraisal process. In microfinance, clients and peers could be involved in the appraisal process to provide a well-rounded perspective on an employee's performance. In addition, employees should not just receive feedback once a year, or whenever the formal appraisal process occurs. The quantitative nature of microfinance makes it possible to provide immediate, daily feedback and for staff to keep score. This increases the role of peer pressure as a management and motivational tool, and reduces the need for middle managers. This approach can also be reinforced through the use of group incentives.

In a flatter organization, with fewer opportunities for promotion and significant changes in compensation systems, appraisals may have a less overt connection with raises and promotions. Instead, the performance appraisal should include learning and employee development goals, especially in companies with skill-based pay. The performance appraisal process should focus on increasing an employee's value to the team and personal satisfaction with his or her current job.¹⁴² Considering one's personal contribution to team goals, it is important that individual accomplishments are consistent with group goals. Businesses that use a team approach should consider building peer appraisal into the performance evaluation process.

Harper outlines four critical factors for effectively using performance goals:¹⁴³

- (1) Employees must have control over the outcomes;
- (2) Employees must be involved in setting the objectives;
- (3) Objectives must be quantifiable, within a specific time period, and regularly monitored; and
- (4) Achieving the objectives should be linked to individual or group rewards.

¹⁴² Boyett and Conn, pp. 55, 73.

¹⁴³ Harper, pp. 224-227.

Difficult and specific goals lead to higher employee performance—provided the goals are accepted by those who have to achieve them. The degree of employee acceptance is a function of their level of participation in setting goals and the extent to which they perceive that goals are attainable. If the goal is too difficult, employees will not try to attain it, or they will become frustrated and stop trying. It is necessary to reinforce approximations of the desired behavior and take incremental, short-steps that are achievable toward a long-term goal that initially may not seem achievable.¹⁴⁴

To effectively motivate staff, employers need to identify and eliminate organizational barriers to performance by learning “what are the things that make it difficult to do your job?” This process will be more effective if employees are co-architects in removing obstacles. However, managers are often the primary obstacle, and few employees are comfortable saying so. If the performance appraisal process cannot effectively address this issue, the business may consider anonymous staff surveys or suggestion boxes.¹⁴⁵ The Go for Broke exercise described in Chapter 2 represents another approach to soliciting the participation of staff to identify everything in the company they think needs to be fixed.¹⁴⁶

A growing company needs to get employees to motivate and push themselves to achieve higher levels of performance, without paying layers of managers to cajole employees into performing. This can be accomplished by generating staff competition for success based on the percentage above-average performance—this approach should continually improve the average performance.

Managing Growth at the Branch Level

After managing the rate of hiring new field staff, the growth of MFIs is determined by the sum of the growth of each individual loan officer. Since experienced loan officers generally add new clients to replace dropouts, with perhaps a few additional clients to increase their productivity, the bulk of growth comes from new loan officers.

How quickly should new loan officers add new clients? Unless they inherit a portfolio, when loan officers begin, they have no clients and lots of time. In a branch where there is an enormous demand for loans, it is easy for that loan officer’s portfolio to skyrocket. But what goes up fast usually comes down fast. Of course, at the beginning with all new clients during the honeymoon phase of their first loan, the portfolio will have excellent quality—but it will catch up with them. The skyrocketing loan officers were too busy processing new applications to build relationships with their clients, to visit their businesses regularly, and to greet their clients’ families and their neighbors. In microlending, these relationships create a sound foundation for the loan officer’s portfolio and ensure that the quality of the portfolio will remain strong.

MFIs need to manage growth at the branches by using incentives to limit the number of new applications the loan officer submits each month. This encourages field staff to select only the best applicants (assuming there is high demand) and to spend more time building relationships. By building this foundation, loan officers in the long run will have more time to dedicate to managing delinquency and reducing client desertion and, ultimately, to maintaining a larger portfolio. Because loan officers invest in client relationships at the expense of fast growth, they will ultimately reap the rewards of higher productivity.

¹⁴⁴ Boyett and Conn, pp. 73-74.

¹⁴⁵ Harper, Chapter 16.

¹⁴⁶ Hawkins, pp. 223-226.

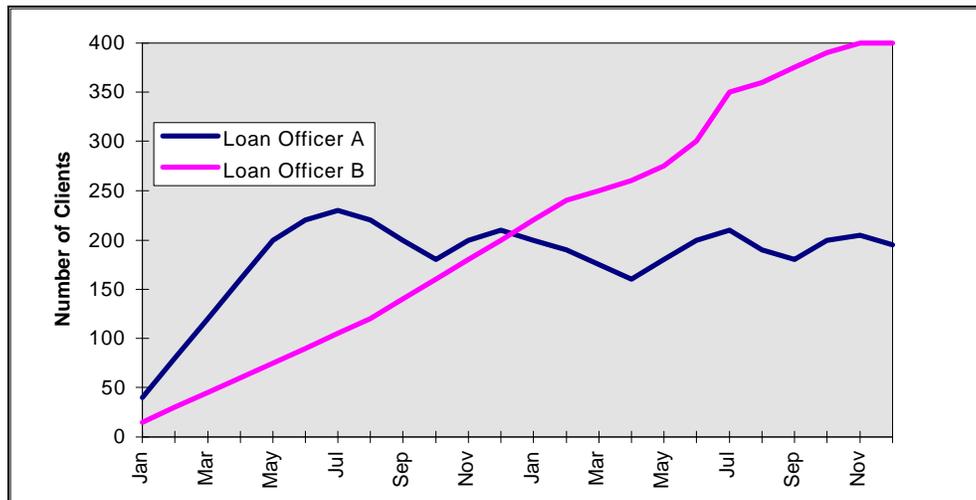
Figure 7: The Tortoise and the Hare

Figure 7 demonstrates this point. Quality problems and client desertion make it impossible for loan officer A to manage more than 200 clients, even though he reached that level after only five months. Loan officer B, however, took longer to reach that level (12 months), but she knew the clients very well. As a result, loan officer B experiences fewer dropouts and almost everyone pays on or before their repayment day. This allows loan officer B to manage a much larger and healthier portfolio than loan officer A, who is still trying to put out fires caused by rapid growth.

The optimum growth rates change based on a loan officer's experience. Incentives that encourage the slow growth of a new loan officer's portfolio can be adjusted over time, but growth should be dampened during the initial months. Because the initial loan quality is perfect, MFIs may delude themselves into thinking that the new loan officer can manage a larger portfolio. This would be a serious mistake. New staff should be encouraged to build a firm foundation, not a large portfolio.

The organization's design and incentives should reinforce the importance of a firm foundation. One way to pace the growth of new loan officer portfolios is to phase out on-the-job training gradually. For example, during the first month on the job, a new field staff may spend 100 percent of their time shadowing an experienced loan officer. For the next three months, they increase the amount of time they operate independently by 25 percent per month, so on-the-job training is only completed in the fifth month. Not only does this approach give new staff more time to learn from their more experienced colleagues, it also reduces the time they have available to grow their portfolio. It is also critical that performance incentives do not reward loan officers for growing quickly. Perhaps during the first year on the job, new loan officers are not eligible for performance incentives, or new loan officers have a different incentive scheme.

An alternative way to manage the growth of a new loan officer's portfolio is through the master craftsman and apprentice approach. Following this approach, new staff are teamed with experienced loan officers, and together they manage and grow an existing portfolio. It should be noted, however, that during the period of joint management, the master craftsman would have the ultimate accountability for the portfolio. After an appropriate term of joint management (perhaps 6 to 12 months), the apprentice graduates and they split the portfolio, preferably along geographic lines to increase efficiency in serving those clients. This approach will help build teamwork and increase

flexibility because the loan officers will become more familiar with each other's clients. It also ensures that new loan officers will not have new clients, and vice versa. MFIs may find that the apprentice approach to training and growth also helps to prevent fraud because it allows for the rotation of clients between loan officers.

Middle Managers

The role of middle managers in a growing company has not yet been clearly defined. Although it will depend largely on the organizational structure and the institutional culture discussed in other chapters, at this point it is useful to consider issues related to middle managers and human resource development.

Even in flatter organizations, there will still be a role for middle-level managers. But the role of middle managers requires a different vantage point. Most managers are quick to blame poor performance on their employees' lack of motivation. According to Harper, Japanese managers adopt a different perspective when performance falls below their expectations. In Japan, there is no such thing as a people problem—there are only management problems.¹⁴⁷

The role of middle managers is no longer to control people and constantly know everything that is taking place. Middle managers need to focus on guiding, energizing, motivating, mentoring, facilitating, and problem solving. Managers need to have a clear understanding of the organization's vision and strategies, and use that as a guideline to improvise as the situation requires. The emphasis is on results rather than methods.

The new middle manager can be seen as a “servant leader” who helps subordinates to achieve results. This generates a customer service mentality from the bottom up. This is the perspective at Federal Express, a U.S.-based courier service. Ask a Federal Express employee how many subordinates report to his or her manager and they are likely to tell you that you have it backwards: “My manager works for the twelve of us to help us succeed at our jobs.”¹⁴⁸

Boyett outlines the following characteristics of servant leaders:¹⁴⁹

- Servant leaders serve first. They do not aspire to lead as much as they aspire to learn.
- Servant leaders lead first by listening. They seek, not to be understood, but to understand.
- Servant leaders help people to articulate their own goals. The listening and questioning are intended to figure out, or help followers figure out, the will of the group.
- Whether it is called vision or mission, the servant leader seeks to clearly articulate it and have the group reach consensus on its direction.
- The servant leader inspires trust. Followers are confident of the servant leader's values, commitment, and integrity. The most important value is the value the servant leader places on the people.

¹⁴⁷ Harper, p. 220.

¹⁴⁸ Tomasko, *Rethinking the Corporation*.

¹⁴⁹ Boyett with Boyett, pp. 185-188.

- The servant leader takes people and their work seriously and is devoted to their personal development. Ultimately, through mentoring and training, the servant leader hopes that everyone will realize their potential—so they too can become servants and leaders.

Managers do not need to control workers through forced obedience. Instead, they need to empower employees to reach their potential. Employees can be perceived as partners responsible and accountable for quality, who monitor relations with customers and exercise initiative to respond to customer needs—which they should strive to anticipate. Employees as partners are willing to do what is necessary to help the company grow and succeed. But they still take their cue from the top. A chief executive officer who is willing to sweep the floor or make coffee for staff can expect the same commitment from all levels of the organization. Employees are willing to do whatever is necessary if they are motivated and managed to align their personal needs with those of the company as a whole.¹⁵⁰

Where do middle managers come from? The literature is mixed on this point, perhaps suggesting a mixed approach is the best choice. On the one hand, it is preferable to promote from within. If the firm has a long-term relationship with an employee who has developed, learned new skills, and demonstrated leadership attributes and abilities, that person should be considered a strong candidate if a management position opens up.

People should be promoted only because they can perform the responsibilities of the new position. Large organizations require a disproportionately larger number of managers perhaps because of the continued need to promote staff. This results in promoting people to their level of incompetence. MFIs are often victims of this. Good loan officers do not necessarily make good branch managers. A growing organization needs to find ways of rewarding and motivating staff without creating unnecessary layers of managers who are checkers who check checkers. They also need to ensure that, when staff are promoted, they are well trained for their new responsibilities before they assume them.

Companies that promote from within encourage other staff to attain the goal of promotion. Internal promotions may also make the transition easier. During periods of rapid growth, a new external manager may not have time to learn on the job. In this case, someone from the inside who already knows the organization and its work may be a better candidate. On the other hand, all businesses need a fresh injection of people at all levels to avoid becoming in-bred.¹⁵¹ Firms need to be aware of the pitfalls of promoting people into positions that are above their heads and the advantages of bringing new perspectives into the company, and then find a way to incorporate both approaches.

Collins and Porras' research indicates that the most successful firms develop, promote, and carefully select managerial talent grown from inside the company. The visionary businesses do this as a key step in preserving their core values and institutional culture. The authors conclude that, "it is not the quality of leadership that most separates the visionary companies from the comparison companies. It is the continuity of quality leadership that matters...the visionary companies have had better management development and succession planning."¹⁵²

In microfinance, there are additional advantages of promoting from within. Although succession has not yet been an issue at the Grameen Bank, staff development for leadership positions is a priority. Almost all senior managers, with the exception of a few technical specialists, initially served

¹⁵⁰ Boyett and Conn, pp. 83-84.

¹⁵¹ Tomasko, *Go For Growth*.

¹⁵² Collins and Porras, pp. 173-174.

as loan officers or branch managers. Consequently, senior staff have an intimate appreciation for the challenges of working in the field and are especially committed to ensuring that main office provides excellent service to its internal customers.¹⁵³

If the firm hires from the outside, Harper strongly discourages businesses from trying to save a few dollars by cutting corners on talent. A business that would rather hire two young and less-experienced managers at \$25,000 rather than spend \$50,000 to hire an experienced manager is likely to find itself in perpetual fire-fighting mode.¹⁵⁴ The most successful firms invest in talent, and they do so before they need it so the key people are in place and acclimated when the firm needs their knowledge, skills, and experience. These people are not intimidated by growth because they have experience running much larger businesses.

One of the greatest mistakes many companies make is to keep managers in place long after the reason they were originally selected disappears.¹⁵⁵ It is important to know when to cut your loses. In some growing companies, managers cannot keep pace with the growing needs of the company. Some individuals reach a plateau in terms of their capacities that re-training cannot overcome. Chief executive officers need to recognize that they must let go of people, who may very well be their friends, and move on. They also must cultivate and nurture new managers. The decision and the handling of this delicate situation need not be callous, but it must be done if the company is to expand successfully.¹⁵⁶

Managers' agendas, at all levels, are filled with mundane and unplanned activities. The trick is keeping focused on their time horizon. This is determined by how they spend their time, who they see, what is discussed, and which performance indicators are most closely watched.¹⁵⁷ It is very easy for managers to become mired in the day-to-day demands of their jobs, and lose sight of their appropriate time horizon—these managers will not be able to effectively manage growth.

A growing organization requires its managers to be more than managers. It needs them to be leaders to get the best and most productive performance out of their employees. Boyett and Conn describe the following difference between managers and leaders:

Managers have employees. Leaders have followers. Managers command and control. Leaders inspire and empower. The manager's authority is legitimized by his or her position title. The leader's authority is legitimized by his or her vision and ability to communicate that vision to followers. Managers seek stability, predictability, and to be in control. Leaders accept the world as fluid and constantly changing. They do not respond to change as something to be avoided or minimized as managers often do, but something to be encouraged.¹⁵⁸

It is important for managers of growing companies to develop an awareness of leadership skills for two reasons. First, managers who want to be leaders can self-evaluate using bottom-up appraisal techniques to assess their competency in these qualities and to find ways of compensating for

¹⁵³ Rhyne and Rotblatt, p. 75.

¹⁵⁴ Harper, p. 24.

¹⁵⁵ Tomasko, *Go For Growth*, p. 212.

¹⁵⁶ Edward Lowe Foundation.

¹⁵⁷ Tomasko, *Rethinking the Corporation*, p. 133.

¹⁵⁸ Boyett and Conn, p. 146.

weaknesses through training or by hiring people with complementary talents. Second, managers need to identify and nurture leadership potential of staff for future middle-level and senior management positions. If a growing business can develop internal leadership talent, it will be able to retain strong employees, attract good employees, strengthen the institutional culture, and reduce the costs associated with hiring managers from the outside. It is difficult to find strong leaders—when possible, it is better to create them. The process of leadership creation also includes leadership renewal. Rising stars in the organization should be encouraged to take sabbaticals to further their education and broaden their experiences.

Although most of the information presented in this chapter is drawn from the corporate business literature, it has direct bearing on all MFIs, regardless of their institutional type. Microfinance is a service industry. As such, it is possible to consider the firm's employees as its products. If MFIs do not have well-trained staff in the right place at the right time, the MFIs run the risk of being out of stock. They have the potential to expand rapidly, but will not be able to do so without the necessary human resource infrastructure. Although employees in MFIs may be more important than they are in most business, most MFIs are non-profits, which have a tendency to short-change their human resources. NGOs are usually constrained by a lack of financial resources, which influences decisions regarding human resource development. The information presented here is based on a paradigm about people in the workplace, regardless of the institution's ownership structure. Socially motivated organizations generally lag behind profit-driven companies in the way they treat their staff. If these organizations are serious about accomplishing their social agenda, however, they need to find a way of attracting and retaining quality staff.

CHAPTER 4: ORGANIZATIONAL STRUCTURE

Most organizational structures represent their companies' histories instead of their promise. The organizational design reflects old political adjustments and past strategies, and does not provide a power base on which the business' future growth depends.¹⁵⁹ To consider the future, businesses need to ask why is the organization currently designed the way it is? Does the design indicate a holistic picture of the organization, or did it develop through a series of incremental changes where pieces and parts were added here and there? "A need may go away, a problem get solved, or a constraint disappear, but the past often lives on in organizational charts."¹⁶⁰ To effectively manage growth, companies may need to rethink their organizational design by looking to the future.

MFI's range in size and stage of institutional developmental. Therefore, the organizational structure will undoubtedly vary from institution to institution. An ideal organizational structure does not exist. This chapter discusses some theoretical issues that could be considered by organizational architects who are designing a structure for a growing organization, including the design features and the institutional building blocks. At the end of this chapter, these issues are applied to the unique case of microfinance.

Design Features

Growth is dynamic, not mechanistic—it is a journey and a process. The design of a growing company must reflect these characteristics. As the marketplace and competition change, a company's structure and management practices will also change.¹⁶¹ To create a fluid, flexible structure, companies should consider a lean, flat, and simple design that facilitates the flow of information and meets the requirements of the key stakeholders.

Lean, Flat, and Simple

Large companies around the world are downsizing, rightsizing, and reorganizing to cut costs and to establish organizational structures that are responsive to changes in the market. Despite the advantages of size, such as economies of scale, access to resources, and stability, size also has its drawbacks. Big companies are not as flexible or as agile as their smaller competitors. The larger the company becomes, the more it builds layers of bureaucracy and management. As a result, it may lose touch with its customers and no longer be able to innovate. To have the flexibility to respond to rapidly changing customer demands, many companies are moving toward a flatter and leaner structure.¹⁶²

The simpler, the better. Growth in microfinance involves reaching as many people as possible. It is best to minimize the complexity of the institution to achieve this objective. "For a large organization to be effective," believes John Welch the chief executive of General Electric,

¹⁵⁹ Tomasko, *Rethinking the Corporation*, p. 17.

¹⁶⁰ Tomasko, *Rethinking the Corporation*, p. 18.

¹⁶¹ Tomasko, *Rethinking the Corporation*, p. 54.

¹⁶² Boyett and Conn, pp. 2-5.

(I)t must be simple. For a large organization to be simple, its people must have self-confidence and intellectual self-assurance. Insecure managers create complexity... People must have self-confidence to be clear, precise, to be sure that every person in their organization understands what the business is trying to achieve.¹⁶³

This architectural perspective clearly links the organizational structure with human resource development and the institutional culture. The three components must be consider collectively.

By understanding the “flattening” of the corporate world, MFIs may be able to skip the stage where they might become fat and hierarchical with layers of unnecessary middle managers. Although few MFIs are currently bureaucratic, extensive growth could result in an inefficient organizational structure if institutions are not wary of the possibility. With their already high cost structure, MFIs certainly cannot afford to become top-heavy. Growth-oriented firms need to minimize the levels of management between senior executives and everyone else. Tall management hierarchies add overhead expense and distort the flow of information.¹⁶⁴

MFIs should remember that overhead is not necessarily bad. Tomasko suggests that there is good and bad overhead. The purpose of good overhead is to make things better, such as research and development and staff training.¹⁶⁵ He cites the example of Exxon, which in the 1980s downsized to become “lean and mean,” but at the price of cutting muscle as well as fat. Its research budget was cut by 20 percent and head office staff were reduced from 1,362 to 320. Exxon’s poor response to the Exxon Valdez oil spill in 1989 has been attributed to these reductions.¹⁶⁶

Flow of Information

In organizational hierarchies, the most difficult paths of communication are those that go up the chain of command. These paths are too congested with concerns about authority, accountability, dependency, evaluation, leadership, and status to serve as effective communication conduits. In most businesses, information—and rumors—flow fastest across the hierarchy, from peer to peer. Less energy and effort are required to move horizontally—the lesson for organizational design is to minimize the vertical height of the structure in favor of horizontal expanse.¹⁶⁷

Historically, the span of management control has been approximately one manager for every five to seven employees. Advances in technology and management techniques make it possible to increase that ratio. The old ratio reflected the number of employees a manager could effectively control. As employees become more self-motivated and are managed horizontally through work teams, the key factor determining the span ratio is the number of employees with whom a manager can effectively communicate.¹⁶⁸

The organizational design should ensure that the right information gets to the right place at the right time. In a flatter organization, lower-level employees need to know more and understand more

¹⁶³ Cited in Tomasko, *Rethinking the Corporation*.

¹⁶⁴ Tomasko, *Go For Growth*, p. 209.

¹⁶⁵ Tomasko, *Rethinking the Corporation*, pp. 62-66.

¹⁶⁶ Tomasko, *Rethinking the Corporation*, pp. 24-25.

¹⁶⁷ Tomasko, *Rethinking the Corporation*, pp. 107-110.

¹⁶⁸ Boyett and Conn, pp. 28-29.

about their company. They need to understand its strengths and weaknesses with regard to the competition. They need to be familiar with their company's financial performance, the demands of the target market, and the company's efforts to satisfy these demands. Employees should know the company's five-year objectives and the role of the employee's work group in fulfilling those objectives. Priority should be placed on getting information into the hands of those who can use it most efficiently to change performance results—the workers themselves. If employees are given access to this information, they also may require additional staff training so they know what to do with the information.¹⁶⁹

Loan officers, for example, need information about the performance of their own portfolio so they can control delinquency and manage their own growth. No one will disagree with that. However, they also should have access to information about the performance of their peers, the profitability of the branch, the status of research and development activities, and the success of the entire company in achieving its short- and long-term objectives. When employees have access to the same information as managers, they are more likely to understand the decisions about needed changes in the workplace and to work cooperatively to implement those changes. Alternatively, withholding information creates adversarial relationships between staff and managers, promoting distrust, suspicion, and resistance to change.¹⁷⁰

Another challenge is to break down communication barriers between different functional units in the business, such as between marketing and product development, or between the finance and operations departments. This is necessary to build teamwork and cooperation within the organization and to increase productivity and responsiveness to the market. Working together builds a shared sense of the business as a whole, rather than as one of individual fiefdoms, and will enable the company to provide better customer assistance.¹⁷¹

The organizational design should also consider the flow of communication across the membrane of the firm, between employees on the inside and customers and suppliers on the outside. Boyett suggests that the strongest structure is one built *without* walls—walls between people, walls between business units, and walls between businesses and their customers.¹⁷² The structure should facilitate communication between staff at all levels and the appropriate stakeholders outside the organization, especially customers. The deeper someone is within the organization, the harder it is for them to know and understand the customer. A flatter structure reduces the number of people who are hidden deep within the organization, therefore increasing the number of people who have opportunities to know and understand the customer.

Considering the Stakeholders

From a social perspective, organizations are devices created to satisfy the needs, desires, and aspirations of various stakeholders, both inside and outside the organization.¹⁷³ Following this

¹⁶⁹ Boyett and Conn, pp. 49-54.

¹⁷⁰ Boyett and Conn, pp. 49-54.

¹⁷¹ Ross and Kay, p. 39.

¹⁷² Boyett with Boyett, pp. 63-64

¹⁷³ Nadler et al., p. 41.

perspective of the organization, to support growth the structure must be responsive to two sets of key stakeholders: customers and employees.

What design provides the most effective customer service? How does the design allow the institution to learn the needs of its clients and then respond to them? Most companies are not organized around markets. They are organized around products. If you go to the bank to make an inquiry, you can either speak with someone in the personal checking, the mortgage, or the commercial departments. If you want to transact business across the internal boundaries of the bank, you may spend all day trying to talk to the right people. This suggests that decision-making processes need to be designed to revolve around the customer, rather than around the product. How can a financial institution become a market-centered organization and present its customers with a unified face? What will the organization look like?¹⁷⁴

To improve customer service, decisions need to be made quickly by responsible employees at the point of customer contact. Critical to the success of the organizational design is a structure that empowers individuals close to the customer or product to make decisions and be responsible for the success of the business. Front-line staff have to be knowledgeable about the business; they must have access to considerable information and the authority to act.¹⁷⁵ In addition to improving the responsiveness to the customer, this approach is also in the best interests of the employees who generally prefer to be knowledgeable and empowered.

Most employees want stable work environments, where they are challenged and have the opportunity to learn, and where they feel secure. Growing firms, which are naturally dynamic and fluid, may find it difficult to create a stable work environment for employees when in fact things are rapidly changing. However, they can easily engage employees at all levels to address the challenges associated with growth. This will make the work environment more interesting; motivate employees; and, most important, improve the strategic decision making process.

What structure will be most motivating and rewarding for staff? According to an *Inc.* survey of 2,800 workers conducted in the United States in 1987, working for a smaller company was more satisfying because employees felt they had more challenging and interesting work, and a better chance to see their ideas adopted, and felt a higher sense of accomplishment. In addition, smaller companies are perceived to be more concerned about quality and do a better job of listening to customers. The working environment is more of a family or community than an unfeeling hierarchic bureaucracy. Architects should consider designs that create this small business environment within a large and growing institution.¹⁷⁶

Building Blocks

A durable, growing organization requires a strong foundation. Chapter 3 described ways of developing, motivating, and rewarding staff. Strong individual staff members are good building blocks, particularly if the individual grows with the organization. This section will consider groups of staff members in teams and business units as alternative building blocks for a growing organization.

¹⁷⁴ Ross and Kay, pp. 41-42.

¹⁷⁵ Jay R. Galbraith, Edward E. Lawler III, and Associates, *Organizing for the Future: The New Logic for Managing Complex Organizations* (San Francisco: Jossey-Bass Publishers, 1993), p. 69.

¹⁷⁶ Boyett and Conn, p. 41.

Teams

There are limits to how much depth, flexibility, and self-control can be structured into any one job. Many work activities are so broad they cannot be accomplished by one individual. They frequently require more skills, integration, and coordination than are possible in a series of stand-alone jobs.¹⁷⁷ In these situations, *teams* of individual contributors offer a good alternative as an organizational building block. However, before discussing the team approach, it is first necessary to consider the design currently found in most firms: the functional corporate structure.

Companies are generally organized around functions as the basic work unit. Businesses with a functional structure are organized by the type of work that people do, such as finance and administration, human resources, marketing, product development, customer service, and sales. Some of the functions are further sub-divided. For example, the marketing department may be separated by product line. These functions are linked vertically to form a divisions.¹⁷⁸ Tomasko notes that, “Functional thinking—and the blinders that come with it—dominates the organizations of most of the world’s companies. This, of course, leads to the wall building and the corporate sclerosis.”¹⁷⁹ In the functional approach, communication and coordination between the divisions tend to be poor, and therefore any work that requires the involvement of multiple divisions may take longer to conclude. The vertical structure of the functional approach also has limited flexibility. People are not easily reallocated between divisions in response to changes in the market.

PURPOSE OF THE TEAM APPROACH

Teams represent an alternative approach that may help improve the competitiveness and the customer service of the organization. As the building block of the organization, teams can do much of the planning, decision making, and implementing. The primary reasons growing companies organize around teams are to empower employees and to increase productivity. Shonk provides the following examples of how teams can help achieve these objectives.¹⁸⁰

Customer Service. A credit services company found that its functional organization was not providing the quality of service it wanted. When customers called, they were transferred to various persons before they received the service they required. The company reorganized into multi-functional teams that focus on specific customers. Employees were trained to perform several functions to provide faster and higher-quality service.

Speed and Flexibility. In the rapidly changing business environment, organizations need to be flexible and adaptable. In response to this environment, the research division of a company adopted a multi-functional team approach, drawing together several disciplines needed for a project. This allowed the unit to bring a product to market in half the time it took when the organization was structured along functional lines.

Coordination and Communication. Under the functional corporate structure, one of the greatest challenges for senior managers is to coordinate the operations of the various functions. Following a team approach, the responsibility of coordination is assumed by the teams. Where teams

¹⁷⁷ Tomasko, *Rethinking the Corporation*, p. 88.

¹⁷⁸ Galbraith et al., Chapter 2.

¹⁷⁹ Tomasko, *Rethinking the Corporation*, p. 118.

¹⁸⁰ Shonk, pp. 2-8.

are used effectively, they have significantly improved the organization's coordination—the left hand knows what the right hand is doing, and together the two hands are able to accomplish a great deal more. Teams reduce the opportunity for miscommunication across organizational boundaries and misunderstanding about responsibilities.

Employee Satisfaction and Development. By empowering employees to plan their work and make decisions, organizations find that talents are emerging and developing that were neither recognized nor utilized. The team approach provides workers with knowledge and skills, information, rewards, and power they do not have in traditional organizations.

Productivity and Cost. There is considerable evidence to indicate that teams can be an effective method to meet organizational goals, increase productivity, and reduce costs. For example, General Foods compared a pet-food plant organized around teams with one of its traditional plants manufacturing a similar product. The company found the team facility was 30 percent more productive, while maintaining lower overhead costs, than the traditional plant.

TYPES OF TEAMS

A growing institution should consider different types of teams that can be used, depending on the circumstances and the purpose. Some teams are temporary task forces set up to handle crises and problems, and to find specific solutions. Other teams are standing committees, which include members from a cross section of functional departments, to fulfill a specific ongoing function such as cutting costs or developing new products.¹⁸¹ In both these cases, the institution uses the team approach within the traditional hierarchical structure to derive some of the benefits of teams without completely reorganizing the institution.

If teams are used as the only building block of the institutional structure, the organization will have neither individual jobs nor functional departments—only teams, team members, and some limited management superstructure. This approach is more common in countries like Japan, where well-entrenched cultural values favor group over individuality.¹⁸² In countries with an hierarchical social structure, the use of teams in the corporate environment may be introduced on a provisional or pilot basis, initially with limited levels of autonomy.

Shonk believes that the primary factor differentiating the type of team is its level of autonomy. How much autonomy should teams have? This is important question because, the greater the autonomy of the team, the more likely it will affect the organization's structure and processes. In addition, a team with more autonomy is more likely to achieve the objectives of improved productivity, flexibility and coordination, reduced costs, and employee satisfaction. The

¹⁸¹ Tomasko, *Rethinking the Corporation*, pp. 89-90.

¹⁸² Tomasko, *Rethinking the Corporation*, p. 91.

amount of autonomy given to a team can range from making suggestions, to problem solving, to self-management, as illustrated in Figure .¹⁸³

Figure 8: Team Autonomy

Low Autonomy	←—————→		High Autonomy
<i>Suggestion Teams</i>	<i>Problem-Solving Teams</i>	<i>Semiautonomous Teams</i>	<i>Self-Managing Teams</i>
Advisory Committees	Quality Circles	Business Unit Teams	Business Unit Teams
	Inter-functional Teams	Work Unit Teams	Autonomous Work Teams

Suggestion teams, such as advisory committees, have low levels of autonomy with no decision-making or implementation authority, and require no change in the organizational structure or work processes. *Problem-solving teams* research activities and develop effective solutions to work-related problems. They may be organized diagonally, to cut across different hierarchical layers in the organization, or horizontally across different functions. Usually these teams make recommendations, which must be approved at senior levels within the organization, and the team is not responsible for implementing its recommendations. Organizations that are structured functionally often use these teams with limited autonomy as an initial foray into what may result in a complete restructuring of the organization.

Semiautonomous teams are managed by a supervisor and have considerable input to the planning, organizing, and controlling of their work. Team members help to establish the goals of the work unit and make daily operating decisions. This type of team is used when the task can best be accomplished if employees have considerable freedom to act, as in the case of the credit services company described above. In this example, the credit services company maintained a supervisor to coordinate across several interdependent customer service groups when work loads are high for some groups and not for others.

Self-managing teams have the same responsibilities as semiautonomous teams, plus they hire team members and allocate resources. These highly autonomous teams are used where employees need the freedom to act and where there is minimal requirement for coordination with other teams. Self-managing teams require significant changes in the organizational structure and institutional culture. A self-managing team does not fit in an organization that restricts the information and knowledge necessary to make informed, effective decisions. Self-management requires eliminating pockets of “information poverty.”¹⁸⁴

According to Shonk, organizations that increase team autonomy usually do so gradually. Some organizations have followed a progression from low to high team autonomy over a period of years. Organizations that experience success with problem-solving teams may find that managers and employees have learned to work more collaboratively, and these skills frequently carry over to their

¹⁸³ Shonk, pp. 23-33.

¹⁸⁴ Tomasko, *Rethinking the Corporation*, p. 87.

daily interactions. “Problem-solving teams can be the practice fields for the development of skills that are needed to create a more autonomous team.”¹⁸⁵

APPROPRIATE CONDITIONS FOR TEAMS

The team approach is not appropriate to achieve all objectives or in all work environments. Different types of teams are appropriate depending on the conditions, and in some cases a team is inappropriate. “Groups aren’t always the appropriate problem-solving unit. Neither are individuals. Sometimes we would trade all of the meetings for one visionary leader; at other times we would like some input into our futures. It depends.”¹⁸⁶

Companies that reorganize based on multi-functional teams may experience increases in salary and training costs. Growing MFIs certainly cannot afford additional costs unless they are offset by cost savings in other areas and by increases in productivity. Although increased productivity is likely to result from the effective use of teams, not all teams are effective. Poorly functioning teams can deteriorate into groups of unhappy and uncooperative individuals who become less productive than the sum of their individual outputs. Some people, and some cultures, are more individualistic and have difficulty exposing themselves to the will of the group. If not properly implemented, teams can become obstacles to progress that reinforce conformity and kill individual initiatives.

Many of the problems associated with teams are related to the process of organizational evolution.¹⁸⁷ Some people resist any type of change. This certainly is not the type of individual who belongs in a growing organization. But if the change process is well managed, if it is clear to all employees why change is necessary and they believe they will benefit from the proposed change, the process will be made significantly easier. This is only possible if senior management is transparent and freely shares information.

Pockets of resistance may remain, particularly among middle managers. Teams reduce the quantity of managers required—if this does not happen then teams cannot become self-governing and cost-savings will not be realized. Hierarchy will not disappear, but it will be tamed.¹⁸⁸ By reducing the number of layers of management, the team approach profoundly alters the organization’s established career ladders. This will create resistance from individuals whose career objectives were anchored to the functional and hierarchical structure.

According to Matejka and Dunsing, teams are good when a project needs the commitment of members to succeed in implementing and there is no clear expert on the problem. A team approach is appropriate if a variety of expertise is required, the organizational climate and reward systems supports group efforts, and people want to be empowered. The converse of these points would describe a situation when the team approach may not be the most effective.¹⁸⁹

¹⁸⁵ Shonk, p. 29.

¹⁸⁶ Ken Matejka and Richard J. Dunsing, *A Manager’s Guide to the Millennium: Today’s Strategies for Tomorrow’s Success* (New York: AMACOM, 1995), pp. 67-68

¹⁸⁷ Shonk, pp. 7-9.

¹⁸⁸ Tomasko, *Rethinking the Corporation*, p. 96.

¹⁸⁹ Matejka and Dunsing, pp. 67-69.

Walton describes the following institutional elements that are necessary for teams to be effective building blocks:¹⁹⁰

- Whole task jobs—that is, doing a job from beginning to end—combined with doing with thinking;
- Flexible duties contingent on changing conditions;
- Few layers of hierarchy and mutual influence by both management and employees;
- Minimum status differentials to de-emphasize hierarchy;
- Coordination and control, based on shared goals, values and traditions;
- Variable rewards to create equity and to reinforce group achievements, such as gain-sharing, profit-sharing, and pay linked to skill mastery;
- Employee participation on a wide range of issues; and
- Business data shared widely.

Tough tasks help focus teams best. Teams without challenging goals quickly disintegrate into former teams. In true teams, members are committed to one another's goals to the point where they fail or succeed as one.¹⁹¹

The use of teams as the building block of the organizational structure requires a significant commitment, particularly in the form of staff training. Most teams do not exist naturally. They have to be created. Team building does not happen in the abstract. Teams need to be built around three things: a leader, a mission, and the relationships between team members. If any of these elements is missing, the team's ability to serve as a building block is diminished. The team leader is particularly important. The leader gives the mission a sense of life by continually articulating and rearticulating it. The team leader also shapes the collaborative behavior and reinforces the interpersonal relationships that are necessary for the group to function effectively.¹⁹²

SPECIAL TEAMS

As final note on teams, it is useful to consider two types of special teams that are particularly relevant to a growing company: a growth management team and an executive team.

The discussion regarding teams, although applicable to a growing organization, can also be applied to any organization that wants to increase productivity and employee involvement and to reduce costs. A growing company may want to take the team approach one step further and build a window to future growth opportunities into its organizational structure by creating a parallel hierarchy, which mirrors the existing management structure. This cross-functional team would be responsible for creating an environment for cohesive and planned growth. Because it would be dedicated to designing

¹⁹⁰ Walton, Richard E., "From Control to Commitment in the Workplace," cited in Shonk, *Harvard Business Review*, March/April 1985.

¹⁹¹ Matejka and Dunsing, pp. 71-72.

¹⁹² Tomasko, *Rethinking the Corporation*, pp. 92-93.

growth strategies, rather than managing ongoing operations, the growth management team can spend more time worrying about what the company is not doing instead of what it is doing.¹⁹³

The team approach can be implemented at all levels in the organization. In many companies, titles such as president and chief operating officer have disappeared from the organization chart and have been replaced with a management committee, a policy committee, and the corporate office.¹⁹⁴ As with all teams, the fundamental rationale for establishing an executive team is the creation of synergy—the effective coordination of functions and activities so the performance of the whole is greater than the sum of its parts. Executive teams have emerged because of the need to manage diverse yet interdependent organizational units. This approach is logical for growing companies, particularly when they reach a significant scale that is too consequential for one or two people to make all the strategic decisions on their own.¹⁹⁵ A leadership team also helps to facilitate succession planning. The following example from Motorola helps to illustrate this point:

To reinforce the concept of leadership continuity from within, (CEO) Bob Galvin discarded the traditional concept of a chief executive officer in favor of the concept of a Chief Executive Office occupied by ‘team members.’...Galvin did this in part to ensure that the company would have capable insiders well positioned to assume leadership responsibility at any point.¹⁹⁶

An executive team can also expedite the change process in a large and growing company. The process of introducing new ideas differs with the size of the organization. If one introduces a change in a small company, it is easy to devise an education and training program that will reach everyone directly. The chief executive officer can talk to or be seen by every person in the business. The sense of intimacy and the speed with which change can be implemented are very high. But when the size of the business increases significantly, the chief executive officer can no longer be seen by every employee. Changes need to be introduced using a team of leaders, each of whom must have bought into the change in the first place. This requires the formation of a leadership team at the center of the business.¹⁹⁷

Business Units

In addition to using a team approach, a growing firm may want to consider organizing its teams into business units. Growth is usually managed by increasing the subdivision of the company. In the process of subdividing, the organization may become fragmented, which makes it difficult to communicate and coordinate. One solution is to create small business units within a large company. This produces an organization with the clout of a giant and the nimbleness of an elf. The business unit performs only the activities most vital to its competitiveness. It is organized around market segments, and kept small so that minute divisions of labor are unnecessary.¹⁹⁸

¹⁹³ Tomasko, *Go For Growth*, p. 260.

¹⁹⁴ Nadler et al., p. 209.

¹⁹⁵ Nadler et al., pp. 210-214.

¹⁹⁶ Collins and Porras, p. 179.

¹⁹⁷ Ross and Kay, p. 176.

¹⁹⁸ Tomasko, *Rethinking the Corporation*, pp. 107, 118.

A business unit is a company within a company. It serves as its own profit center, and it sources external support services either from the corporate superstructure or external agents at market prices. If it is not happy with a particular service or the cost of the service provided by the corporate head office, such as computer support or wholesale loan funds, the business unit has the autonomy to find these services elsewhere. This forces the head office to improve the quality and cost of its services, therefore improving the competitiveness of the entire company.

In most corporations, serious debate about organizational structure is limited to the jobs in the top third of the organization chart. Bottom-up planning and the critical importance of the business's horizontal structure are often ignored or resolved in an uncoordinated manner. What from the top down might look like a great deal of freedom and flexibility is, from the bottom up, an uncoordinated, under-leveraged patchwork of middle-management fiefdoms.¹⁹⁹ By starting the design of the organization at the bottom, beginning with the customers, the company is likely to conclude that a business unit approach helps to keep as many people close to the customers as possible. These smaller business units possess an economy of focus. They have a knowledge of the local market, they are more flexible and faster because they have less decision-making hierarchy, and they have a favorable image in the community and are better suited to providing quality products that are appropriate to the needs of the customers.²⁰⁰ The corporate structure, which is then built to support the activities of the business units, will look more like a "solar system" than a pyramid.²⁰¹

Employees prefer working in smaller businesses where they find more challenging and interesting work, have a better chance to see their ideas adopted, and feel a higher sense of accomplishment. In a solar system of business units, senior management is responsible for communicating a vision of the company's future and the key results each business unit must obtain for that vision to be a reality. Business units have wide discretion concerning how they structure themselves and operate to obtain desired results. And they are held accountable for doing so.²⁰² A business unit approach to managing growth can create the autonomy and flexibility to provide a better working environment, while maintaining the security of working for a large corporation.

Organizational Structure and Microfinance

The architects of growing MFIs should consider teams and business units as possible building blocks for their organizations. Most successful MFIs have already realized many of the lessons that are now dawning on the corporate world, such as organizing around customers and markets instead of functions or products. These decisions were obvious when MFIs only provided one or two basic products and the branch retail structure dictated a geographic organizational design. But as MFIs grow, and diversify, they may be tempted away from their roots into a pyramid structure that has dominated the organizational design of most businesses. MFIs that move from the non-profit into the world of formal finance, for example, should avoid using the commercial bank organizational structure as the model for their design. This section will consider the use of teams and business units to remain true to the organizational structure of microfinance.

¹⁹⁹ Tomasko, *Rethinking the Corporation*, p. 118.

²⁰⁰ Wendel.

²⁰¹ Boyett and Conn, p. 30.

²⁰² Boyett and Conn, p. 28.

If portfolio quality and customer service are the objectives of the MFI, what organizational structure is most conducive to achieving these goals? In both cases, the closer employees are to their clients, and the more contact they have with them, the easier it will be to achieve high quality and provide excellent service. This is apparent with loan officers, and well documented by Rhyne and Rotblatt:

The organizational charts of large microenterprise finance organizations reveal a simple, characteristic pattern: a set of small retail outlets that do the front line work, linked by a superstructure that provides higher level of services and oversight to the units. This pattern...is derived from one of the basic principles involved in providing financial services to the poor: that (retail outlets) must be located close to clients, whose ability to spend time and money obtaining banking services is limited.²⁰³

This principle should be applied to the entire organization, from the managing director on down. The organizational structure should support the proximity between client and all personnel by encouraging the regular interaction between them and rewarding that behavior. The more interaction head office and regional staff have with their internal and external customers, the better they will understand the customers needs and the better service they will provide.

Teams in Microfinance

In microfinance, managing growth requires getting employees to be more productive with fewer resources. This can be accomplished through suggestion committees of employees of all levels, which are charged with identifying ways to increase productivity, reduce waste and costs, and improve quality.

By working as a team at the branch level, a group of field staff may reorganize their roles and responsibilities to significantly increase their productivity. For example, in some MFIs teams of five loan officers organize their schedules so they each spend one day in the office to provide services to all clients, and four days in the field. This arrangement reduces the need for tellers and makes it easier for loan officers to get to know one another's clients.

MFI branch offices could be organized into autonomous teams because they operate in an environment in which employees need the freedom to act and where there is minimal requirement for coordination with other teams. Although branches can learn from one another's experiences, there is little need to coordinate efforts between branches. If the team is provided with sufficient information and training to manage itself, this could reduce the need for branch managers. In the absence of a formal supervisor, team members assume responsibility for most traditional supervisory responsibilities. These extend not only to monitoring performance and solving performance problems, but also to areas such as planing, scheduling, budgeting, hiring, and discipline of team members. The remaining managers ensure that the self-managed teams have sufficient resources, advise them on technical issues, and help resolve disputes.²⁰⁴

Teams are not entirely useful for external contacts with clients. Since the personal relationship between loan officer and borrower is central to the lending methodology, it would be unwise for clients

²⁰³ Rhyne and Rotblatt, p. 31.

²⁰⁴ Boyett and Conn, pp. 239-240.

to have impersonal contact with numerous branch staff. However, this close bond between loan officer and client also makes the institution vulnerable to staff turnover and fraud. If a staff member leaves the organization, other people in the branch need to know the loan officer's clients and where they live or work. It is also important that clients know and trust the other staff in the branch. Regarding fraud, a long-term cozy relationship between loan officer and client may create conditions in which kickbacks or bribes occur. Singular responsibility for clients also makes it possible for loan officers to create ghost groups. To minimize these vulnerabilities, some MFIs rotate portfolios among loan officers or use an apprentice approach to training so that multiple staff members are familiar with the clients.

In traditional branch offices, responsibilities are often delineated based on function, between tellers, credit officers, bookkeepers, and managers. In a small office, this fragmented division of labor reduces the flexibility of the branch to respond quickly to sudden changes in demand. The traditional separation of responsibilities is for two primary purposes. First, the split between teller and bookkeeping roles is a standard accounting principle for internal control and fraud prevention. Any reorganization at the branch level to include autonomous teams must respect this separation.

The second reason for the separation of responsibilities is the traditional approach to a hierarchical structure, where every branch has to have a branch manager. The need and usefulness of branch managers must be carefully scrutinized. It is possible that many of the responsibilities of the branch manager could be assumed by an autonomous team of loan officers. If there is a need for a more senior person at the branch level—for internal control purposes, for example—these duties could be performed by a team leader or a senior loan officer.

In an autonomous branch, all personnel would eventually be trained to perform all branch responsibilities. With each new skill they learn, their base salary would increase. Staff could then be deployed to meet the changing demands of the market. This would require revisiting hiring procedures to screen for self-starters and team players. Training curricula would have to include new sets of skills such as problem-solving and team-building exercises. Teams do not exist naturally; they have to be made. Training would also have to reorient staff to consider the addition of new skills as preferable to the traditional career path.

In self-directed work teams that operate without a formal manager, performance reviews and rewards should be based on a combination of group and individual performance. In true teams, members are committed to one another's goals to the point where they fail or succeed as one.²⁰⁵ This suggests that, for the team approach to work in microfinance at the branch level, it is necessary for field staff to realize their destinies are intertwined.

At the head office, each financial product could have its own team that cuts across functional lines. For example, a product team might include members with backgrounds in finance, management information systems, operations, research and development, and marketing. Some team members would serve concurrently on several teams. Together, a product team is responsible for developing, piloting, implementing, and supporting a specific financial product. This longitudinal approach—managing the life of the product from conception to ongoing support—improves the likelihood that the organization does not just launch a new product, but it launches a successful product. This is similar to the fire-fighting teams used by the Grameen Bank, which move from branch to branch as necessary to respond to problems in the field.²⁰⁶ The business units would be the customers of the product team.

²⁰⁵ Matejka and Dunsing. p. 74.

²⁰⁶ Rhyne and Rotblatt, pp. 57-58.

Branches that provide various financial products would interact with several product teams, but not all branches would necessarily provide all products.

Business Units

Many MFIs already understand the business unit concept that is recently dawning on the corporate world. The branch as a business unit or profit center was pioneered by BRI as a model for decentralization:

Every BRI unit operates as a mini-financial institution, in that it raises funds and invests them, while charging a spread to cover its operating costs. Funds are raised from savings deposits and invested either in...loans or in deposits with the main BRI branches (on which the unit earns interest income). A unit which is short of funds to meet loan demand may borrow from its supervising branch at a cost set by BRI policy makers....Units are also responsible for the operating costs they incur, in the form of salaries, other direct administrative costs, and costs paid internally to BRI for services to the units. Each month, units prepare a profit and loss statement and a balance sheet, showing a bottom line in the form of unit profits.²⁰⁷

This approach suggests that MFIs should test their assumptions about economies of scale. What functions that are currently provided by the corporate or head office could be provided at a branch or regional level to improve the quality of services provided to customers, to improve the quality of employees' work content and environment, and to reduce costs? In answering this question, it is useful to consider shades of gray, rather than black and white. In order for some responsibilities to be delegated to the branch or regional level, they may need to be accompanied by a centralized support function.

Well-trained and motivated field staff are flexible employees who can, and would like to, assume a variety of responsibilities. Below are some examples of how more functions could be delegated to individuals who have regular customer contact.

Human Resources. At the branch level, prospective teammates should have the primary responsibility for hiring their co-workers. It is critical that peers can work together cooperatively, and therefore team members have to be involved in the screening and hiring process to ensure they are comfortable with the candidates. An even greater challenge is for the team to assume responsibility for performance appraisal, discipline, and termination. The branch is likely to require assistance in these areas from one of the remaining middle managers.

Staff Training. There are economies of scale associated with a centralized staff training function, particularly when common products are offered in most or all branches. In addition, it is important for field staff to participate in centralized orientation sessions to create a common corporate culture that transcends the business units. However, as branches introduce different products and offer different services, training needs to be customized to the unique menu of each business unit. Training can therefore be separated into general issues, which apply to everyone and which should be addressed through a centralized approach, and technical training, which is implemented in a more decentralized manner.

²⁰⁷ Rhyne and Rotblatt, p. 54.

Marketing. If an MFI operates only in one market, a centralized approach would be more cost effective. However, as the organization grows and enters new markets, each marketing strategy needs to be customized from the bottom up. Perhaps a new branch is located in a community where customers speak a different language or honor different traditions. Perhaps radio or newspaper advertising is appropriate in some markets, whereas flyers, posters, and village meetings work better in others. After each branch develops its own marketing strategy, it may be possible to achieve some economies of scale by coordinating efforts—for example, by mass printing brochures or posters. But a centralized initiative, such as printing brochures, should begin only following the bottom-up process; otherwise, the MFI may be stuck with thousands of useless brochures.

Sourcing Supplies. This too can be pursued from both a combined centralized and decentralized perspective. If a business unit can find less expensive supplies from a local source, it should be allowed to purchase locally. Alternatively, if by buying in bulk a central office can lower costs, including shipping and corporate overhead, a centralized approach might work. But cost is not the only determining factor. The quality of service is also important. For example, if a centralized photocopy machine service contract does not result in timely responses, a more expensive and more responsive arrangement with a local service agent may be more appropriate.

Credit Approval. Successful MFIs learned long ago that, with the proper use of management information systems and internal control procedures, the authority for all credit approval within specified parameters (that is, up to a maximum loan size) should be decentralized to the business unit. This allows the branch to determine the quality of its customer service, without blaming late disbursements on faceless bureaucrats at the main office. The transition from a centralized to decentralized decision-making system requires more than introducing computers in branch offices. The branch offices have to be given the autonomy and authority to make their own strategic decisions in order to attain their pieces of the overarching corporate objectives.

The organizational structure provides a key context for shaping behaviors. For example, how employees are grouped, and the way these groups are ordered in relation to one another, can influence whether a new product flourishes or languishes.²⁰⁸

All sustainably successful companies are essentially centralized, but—and this is the real trick—they are centralized in a way that can allow for a tremendous degree of local autonomy. It is possible to have your cake and eat it, too, if careful employee selection and extensive training are done before granting autonomy and if computer-based information systems are used to provide a performance monitoring safety net.²⁰⁹

In a centralized organizational structure, the center tends to get overloaded with a pile of little problems. The center may try to solve the problems by setting up a special team dedicated to little problem solving. But the little problem-solving team cannot get to all places at the same time, and the little problems keep mounting. In a decentralized structure, the authority to deal with little problems is delegated to the locations where the problems are occurring.²¹⁰ The problems can be addressed swiftly, and perhaps even be prevented, especially if there are rewards attached to the authority that encourage prevention as a solution. But the center is still needed to address big problems. The

²⁰⁸ Tomasko, *Rethinking the Corporation*.

²⁰⁹ Tomasko, *Rethinking the Corporation*, p. 19.

²¹⁰ Ross and Kay, pp. 19-20.

challenge is to discriminate between the big and small problems, and to authorize the branches to resolve the little ones.

Microfinance Growth Strategies

How does an MFI decide when and where to open new offices? The answer to this question illuminates the institution's growth strategy. Does the MFI expand through concentrated growth that gradually extends the boundary of its existing market, or does it enter new markets, in other cities or regions, before reaching local market saturation? Sometimes there are political advantages to entering new markets, but it results in a dispersed organizational structure that may complicate growth by requiring unnecessary layers of management and excessive overhead costs.

Just as the span of management can increase if the institution implements information technology and management techniques, so too can the number of new offices be increased. But this should follow a two-stage approach to avoid premature or excessive growth. During the first phase, a young and developing MFI should open branch offices slowly and in close proximity to one another to facilitate horizontal learning. Proximity also allows for effective supervision to monitor and test policies and procedures. Once the MFI is comfortable with its basic methodology, is achieving excellent results in terms of portfolio quality, customer service, and client retention, and is profitable, it is ready to replicate its model in numerous sites. During this expansion phase, the MFI needs to manage growth by relying on management information system and self-managed work teams, and by trusting well-trained employees.

Some MFIs use their social mission to rationalize the geographic dispersion of their activities. They argue that, by opening new offices, they can provide access to financial services to more low-income communities. However, from a social perspective, the overall impact of a program is more significant if it maintains a geographic concentration of clients and branches. The depth of results achieved by an MFI that strives for market saturation in a specific region is more effective in poverty alleviation than an organization that has wide but thin coverage.

There are two reasons for this. First, by striving for market saturation, the MFI works harder on social intermediation necessary to provide financial services to segments of the community that may be more disadvantaged. Second, an MFI that does not regularly replicate a standard model in new communities is more likely to channel resources into new product development to provide its market with a range of services to meet their needs. It is also worth noting that the breadth of relationship with customers and a geographic focus will help protect the institution from competitive challenges, whereas a one-product institution with wide coverage is more vulnerable to competitors and will respond with less agility.

For an MFI to be sustainable and durable, the decision when and where to open new offices must be based on economic and strategic, rather than political, reasons. Often donors and influential persons try to convince MFIs to open offices in a particular community because this is consistent with the political agenda of external agents. The challenge for a growing MFI is to evaluate each potential site as an economic and not a political opportunity. If the MFI does not conduct a feasibility study, an initial grant may lure the institution into opening a new office in a community that ultimately does not possess a large enough market to support the overhead of the branch. The next year the political will of the donor may change, the grant money for the branch office may dry up, and the branch will operate at a deficit. Given the level of labor-intensity involved in microfinance methodologies, geographic

concentration of its client base is the key to maximum productivity. The economy of focus resulting from a concentration of clients generally outweighs the political benefits of a dispersed branch network.

Each branch should be a business unit that is organized around clients not functions. The objective for each office is to become profitable, including paying for the services that it receives from the central office. To minimize the costs of opening new offices, growth can be achieved through the amoeba approach. Instead of opening offices in far-flung reaches of the country in response to political pressure, a more pragmatic business approach is for the MFI to gradually spread its influence by growing and dividing—which is how amoebas replicate. When a branch reaches maximum capacity, it can split into two offices with different geographic focuses.

In the process of removing or avoiding bureaucratic layers, it is important not to get too flat. Matejka and Dunsing warn businesses not to become so lean that they do not have the strength to support growth or to react in a crisis. Ironically, the motive behind the new wave of employee empowerment often is not a human understanding of the dignity of the human worker, but management's wish to squeeze more out of everyone. Doing more with less has a noble ring to it. Overdone, however, it sets the stage for breakdowns and inept performance.²¹¹

Tomasko notes that, although speed and simplicity are important attributes for a growing corporation, these qualities need to be pursued with both eyes open:

(J)ob cuts among the fish cleaning crews at H.J. Heinz's Star-Kist tuna canning factories so overworked those remaining that literally tons of meat were left on the fish bones each day. Staff was then increased, the extra payroll costs more than covered by the extra production....Citicorp once received many favorable comments in the business press for its fast home mortgage approval process. In the mid-1980s, it set out to become the dominant U.S. housing lender, using this speedy process to provide loans to buyers who provided little or no information about their income or assets. After several years and a lingering recession, the strategy backfired, and repayment of many billions of dollars of its loan portfolio was significantly overdue.²¹²

Should the organization adopt a formal, rigid institutional structure or an informal, loose set of relationships? Neither type of organization is right or wrong. The question is whether the structure supports the implementation of the firm's strategy. In microfinance, where the emphasis is equally shared between the "micro" and the "finance," organizations need to find a balance that works for them. The strength of an MFI is its ability and willingness to serve the micro market. This dictates where the institution locates its offices, how it conducts outreach and marketing, and how it develops a trusting relationship with its clients.

New Frontiers

A final note on organizational structure considers some of the frontiers from the corporate world that may ultimately, if not already, have some bearing on the shape of MFIs. These frontiers of growth include strategic alliances, commercial banks with microfinance windows, franchising and going international.

²¹¹ Matejka and Dunsing, pp. 28-29.

²¹² Tomasko, *Rethinking the Corporation*, p. 61.

An increasing number of companies realize they cannot succeed alone. They recognize the need to focus their talents and resources on those areas in which they have a competitive advantage and let others perform functions that can be done better elsewhere. This growth strategy leads to the establishment of alliances and joint ventures.²¹³ The process of establishing alliances encourages management to take an objective look at its assumptions and consider new ways of doing things, makes it open to new ideas, and forces it to consider an external orientation.

Some large businesses are even establishing mutually beneficial relationships with smaller firms. A number of large businesses have demonstrated it may be better to establish an alliance with a smaller firm than to acquire it. Large firms have greater resources, but smaller firms continue to be more entrepreneurial. Alliances permit emerging firms to keep the entrepreneurial focus that is lost in acquisitions.²¹⁴ A formal relationship with a larger firm may be particularly beneficial to smaller firm because debt and equity (including venture capital) financing is becoming more difficult to obtain.²¹⁵

Alliances are based on synergy whereby two or more entities work together to achieve something quicker, less expensive, of better quality, and/or more convenient than could be accomplished by the entities acting alone. The whole is greater than the sum of its parts. The most obvious alliance in the field of *microfinance* would be between an NGO service provider and a local bank. For MFIs that do not intend to create formal financial institutions, this approach may be the most promising route to growth. The NGO knows the micro aspects. It knows the micro market and has the technologies to provide cost-effective financial services to low-income communities. But it is constrained by its institutional type which limits its access to capital. The bank knows finance. It has the resources, or can acquire the resources, to fund microfinance growth. But it does not have the trust or the familiarity with the market, or the corporate culture, to provide microfinancial services. In an alliance between the two, the formal intermediary would monitor the performance of the MFI and guard against the dangers of rapid growth. In many ways, the formal lender substitutes for the missing owners in providing a disciplining perspective on the process of managing growth.²¹⁶ This should be a match made in heaven, but for reasons that require a thorough investigation, there are few examples of a successful alliances between an NGO and commercial banks.

On another frontier, some banks have decided to enter the micro market on their own. Banco del Desarrollo in Chile is one of the most successful examples of a private commercial bank that provides financial services to the informal sector, including savings and both group and individual loans. Although more research is necessary to learn the success factors of this approach, it is important that the bank establish its MFI operations in a subsidiary company, which can develop its culture and human resource policies independent of the bank.²¹⁷

Another growth strategy that some MFIs are considering involves franchising. With this approach, an MFI would grant the rights to establish independently owned branch offices. In exchange for fees and the obligation to adhere to strict quality standards, the franchisee uses the franchiser's

²¹³ Nadler et al., p. 6.

²¹⁴ Harper, p. 314.

²¹⁵ Harper.

²¹⁶ This insight was provided by Claudio Gonzalez-Vega.

²¹⁷ Initial research on this topic is being done under the USAID Microenterprise Best Practices Project by Baydas, Graham, and Valenzuela entitled "Commercial Banks in Microfinance: New Actors in the Microfinance World" (Bethesda, Maryland: Development Alternatives, Inc.).

trademark and receives marketing support, operation manuals, and staff training, and can borrow funds from the franchiser for on-lending.²¹⁸

Franchising creates the flexibility of the business unit structure described above, while producing additional performance incentives for the franchise owner that the manager of a business unit might not have. If the franchiser offers a useful and profitable franchise model, and develops the services to support this model, this approach has the potential to rapidly increase the expansion of microfinance. It should be easier for the MFI to monitor a franchise, rather than a branch network, and the capital risks are shifted to the franchisee. If the franchisee is willing to adhere to the franchiser's standards and depend on the franchiser for product development and other support services, it can also benefit significantly from this relationship. For example, the franchisee has access to a proven business system, therefore reducing business risks, and can devote its complete attention to operational issues.²¹⁹

Finally, in the discussions above, growth has generally been confined to national borders. One important lesson microfinance can learn from the business world is that markets transcend the nation-state. In the microfinance field, international replication has largely been the domain of organizations based in developed countries that provide technical and financial assistance to MFIs in a variety of countries. Increasingly, the microfinance community may witness MFIs themselves operating across borders in pursuit of their twin objectives of outreach and financial viability. Some MFIs have already initiated cross-border forays, such as the Grameen Trust, Faulu Africa, and Pride Africa.

²¹⁸ Michael Henriques and Robert E. Nelson, "Using Franchises to Promote Small Enterprise Development," *Small Enterprise Development*, Vol. 8, No. 1, p. 23.

²¹⁹ Henriques and Nelson, p. 25.

CHAPTER 5: CONCLUSION—GROWTH AND INSTITUTIONAL DEVELOPMENT

To introduce microfinance to new perspectives, this document was derived largely from the business literature. Microfinance has evolved primarily out of the non-profit, development community. Gradually, it has added expertise from the commercial world, but this piecemeal formalization of microfinance has not taken a holistic look at the lessons from the corporate world. These lessons will become more important in countries where the microfinance market becomes increasingly competitive. Even in locations where MFIs have a monopoly on the low end of the financial services market, an understanding of these lessons will improve the quality of services they provide and improve profitability, allowing the institution to increase its outreach and hence its social impact.

The lessons from upheavals in the corporate world indicate that bigger is not always better. The literature suggests that large hierarchical businesses have been losing market share to smaller, more innovative firms. Businesses that are able to meet customer needs in a rapidly changing marketplace are more likely to be leaders in their industries. In the years ahead, responsiveness to the market and quality products will be far more important than the product price. Smaller firms have the potential to respond more quickly than their larger competitors.²²⁰

In the face of heavy competition, many large corporations are reorganizing in line with new thinking on growth management. Their objective is to combine the strengths of entrepreneurial firms, such as agility, creativity, and a more enjoyable working environment, with the clout of a large corporation. It was not long ago that emerging businesses wanted to operate like Fortune 500 firms. Today, many Fortune 500 firms are adopting corporate entrepreneurship in their strategies and cultures by using autonomous business units to be more opportunistic and agile.

In general, MFIs have to grow. They are compelled to expand by the imperative of sustainability and by their social mission. If MFIs can learn from the experiences from the corporate world, perhaps they can grow wisely. The usefulness of the corporate lessons will vary depending on the institution's stage of development and the level of competition in the market. As the institution and the market mature, these lessons become increasingly relevant.

The traditional approach to managing the growth of MFIs relies on standardization. Following this horizontal or extensive growth approach, MFIs expand by replicating their branch model in new geographic areas. Although this strategy is an essential first step, MFIs, particularly those that operate in competitive markets, need to move beyond a cookie cutter approach.

The traditional emphasis on extensive, rather than intensive, growth contradicts the lessons from the business literature. Horizontal growth increases the institution's overhead costs and is less productive. Horizontal expansion adds complications with regard to communication and supervision that may undermine the success of the institution. When MFIs expand horizontally, they usually replicate one or two standard financial products on a large scale. However, as the literature suggests, if MFIs do not focus on product development, a competitor with a better product could seriously threaten their market share. An MFI that has expanded horizontally will also find it difficult to introduce changes to its products quickly, or to introduce new products.

²²⁰ Harper, p. 282.

This study uses the metaphor of organizational architecture as a framework for analyzing and designing three inter-related components that are essential to managing growth: institutional culture, human resource development, and organizational structure. For MFIs to combine the strengths of entrepreneurship with the clout of a large organization, they need to utilize all three components of the organizational architecture effectively. Managing growth, as defined by the three elements of organizational architecture, is the process of building solid and lasting institutions—that is, institution building. This conclusion considers some of the lessons from the business literature on these three sub-topics as they pertain to the three levels of institutional development outlined at the end of the first chapter: (1) subsidy dependent; (2) operationally efficient; and (3) financially self-sufficient (see Figure 9).

Level I

At each level of institutional development, different strategies for managing growth are required. Start-up MFIs at Level I are usually constrained by limited resources. Unless they receive technical assistance to implement a proven methodology, they are also enduring a trial-and-error process to determine a successful approach to providing microfinance services. They have to be learning organizations that are adaptable and are prepared to change based on the feedback from their clients and field staff. As such, they need to monitor their market carefully and solicit the suggestions and ideas from employees who are closest to the clients. By involving staff at all levels, a young MFI sets an important precedent for staff participation that it should strive to formalize as it grows.

The institutional culture is likely to be one of the greatest strengths of MFIs at this stage of development. During the early days of the institution, the culture may be characterized by participatory management that promotes flexibility and creativity. This is particularly true of MFIs that begin as NGOs, which tend to be more informal than for-profit enterprises. A young MFI, like any young business, is entrepreneurial and therefore innovative and responsive. Although it is difficult to adopt a long-term view as an experimental MFI, Level I MFIs that have their sights on growth could consider building corporate lore, rituals, and a unique lexicon, all of which reinforce a sense of belonging to something special. These motivating factors do not cost anything, and they begin to set this business apart from peers or competitors. As with MFIs at all levels, Level I MFIs need to instill a customer service ethic in their staff and emphasize the importance of portfolio quality.

An MFI at this stage is probably heavily dependent on the charisma and leadership of the entrepreneur who founded the business. This can be either a benefit or a liability, depending on the individual. If the institution is destined to grow, the MFI needs leadership that articulates a clear vision for where the institution is going and how it will get there to provide employees with a framework within which they can take initiative. At Level I, this vision is especially important because it serves as another inexpensive motivating influence, which will help the MFI reach the next level.

Employee selection at Level I may be some of the most important hiring decisions the institution ever makes. The institution wants to hire people who will ultimately form the old guard, the keepers of the institutional history, who will remain with the organization and contribute to its success over the long haul. MFIs that forget their early lessons are doomed to experience them again,

Figure 9: Levels of Institutional Development

	Level I: Subsidy Dependent	Level II: Operationally Efficient	Level III: Financially Self-Sufficient
Institutional Culture	<ul style="list-style-type: none"> Entrepreneurial: adaptable, creative, and flexible Participatory management Visionary leadership Learning organization Build corporate lore and rituals Customer service and quality 	<ul style="list-style-type: none"> Develop formal communication channels to and from clients, staff, and management Create accountability and responsibility for key performance indicators Use benchmarking to compare with the best in the industry Cultivate staff honesty and trust Secure employee commitment through institutional culture Democratize information Customer service and quality 	<ul style="list-style-type: none"> Balance social mission and bottom line Balance entrepreneurial culture with professionalism Continued emphasis on learning and innovation Strong culture and clear vision provide direction to staff in decentralized structure Market research Customer service and quality
Human Resource Development	<ul style="list-style-type: none"> Hire strong core employees who can grow with the business Hire flexible, versatile employees who can perform multiple functions Social mission is the primary motivation 	<ul style="list-style-type: none"> Develop hiring and screening procedures Develop staff orientation to promote institutional culture Develop introductory, on-the-job and ongoing training Develop middle managers as servant leaders Emphasis on non-financial rewards Possibly introduce financial incentives (if motivation from mission wears off) Develop performance appraisal systems Remain slightly understaffed Promote employee flexibility through cross-training 	<ul style="list-style-type: none"> Develop training-of-trainers curriculum Make the institution the employer of choice for current and prospective employees Implement human resource systems developed under Level II on a large scale Minimize staff turnover Hire to create growth Consider innovative compensation packages for staff and managers
Organizational Structure	<ul style="list-style-type: none"> Simple, centralized structure Few branches in close proximity Minimal overhead 	<ul style="list-style-type: none"> Use low autonomy teams to replace informal participatory management Design structure from the bottom up 	<ul style="list-style-type: none"> Decentralized structure: lean, flat, and simple Solar system of autonomous business units Increased responsibility for board of directors Teams where appropriate
Growth Strategies	<ul style="list-style-type: none"> Fine tune technology for basic product Gradually increase field staff productivity Short-term planning (1-2 years) 	<ul style="list-style-type: none"> Standardize systems and procedures Build institutional capacity and infrastructure to support growth Develop a track record of success including a quality portfolio and steady, but not explosive, growth Vertical growth: increase use of existing capacity New branches through amoeba approach Medium-term planning (2-3 years) 	<ul style="list-style-type: none"> Horizontal growth: replication of standard office structure Develop marketing strategies Develop new products Long-term planning (3-5 years) Management succession planning

therefore heightening the importance of the organization's history and the retention of early employees. A Level I MFI wants to employ staff who have the potential to grow as the business grows and who are willing, at least initially, to forgo high salaries for the opportunity of doing something exciting and worthwhile. The social mission of the institution may be felt most strongly at this stage, creating an intangible motivation for staff, which helps to compensate for the lack of financial resources available for salary and financial incentives.

The organizational design of a Level I MFI should remain as simple as possible. MFIs at this stage cannot afford the overhead expenses involved with opening up new branches or hiring new staff. The more focused the institution is on two or three of nearby branches, the easier it will be to learn lessons from mistakes, transfer lessons between branches, and quickly scale the learning curve. A wider distribution of early branches not only adds unnecessary costs but it also delays the learning process.

Level I programs should rely on intensive growth by finding ways to increase loan officer productivity gradually. These organizations are probably not ready to implement any marketing strategies because they do not want to cultivate demand that they cannot satisfy. Planning for MFIs at this level will remain short term because projections beyond one or two years will have no basis. They are also not prepared to introduce new products or enter new markets at this stage.

Level II

By definition, Level II programs have achieved operational efficiency but are not fully self-sufficient. Growth becomes a crucial issue for Level II institutions for two reasons. First, to become financially self-sufficient, MFIs need to reach a critical mass of clients. Second, to cover their operating shortfalls in the interim, they need to present donors and funders with an impressive track record of success that provides credible projections for achieving sustainability. The two important variables of these projections are quality and quantity. The MFI has to demonstrate it has learned important lessons about portfolio quality during its experimental days as a Level I institution, and it needs to show growth trends based on actual performance that will reach self-sufficiency within a specified number of years. The persuasive power of these two reasons make Level II MFIs especially vulnerable to premature growth.

Instead of adding significant size, Level II should focus on building institutional capacity to prepare themselves to grow properly. This includes developing standard systems to provide excellent customer service, implementing procedures for hiring and training staff, and developing effective management information systems including reliable and useful reports for personnel at all levels. Level II MFIs also need to develop effective communication channels for the vertical—between clients, loan officers, and management—and horizontal flow of information to replace the informal channels used as a Level I institution.

The timing of these changes is important because of its impact on costs. A good example is the management information system. When the organization is small, a full-fledged computer system may add too much to its overhead. If the MFI waits too long to upgrade it, however, it can become a critical bottleneck for future growth and a major source of costs and headaches.²²¹

²²¹ This insight was provided by Claudio Gonzalez-Vega.

If these institutions have to grow—and of course they do—it will be easier to build capacity while expanding if they emphasize vertical rather than horizontal growth. This is accomplished by hiring new loan officers for existing branches and by clumping branches close to one another. The proximity of branches facilitates horizontal learning and allows for effective supervision to monitor performance closely and to test policies and procedures. Level II institutions should approach horizontal growth cautiously, perhaps by opening no more than one or two branches a year, and relying solely on the amoeba growth model. This gradual approach is appropriate because, by definition, Level II MFIs are constrained by limited financial resources. In addition, a patient growth strategy will allow the MFI to learn about the challenges associated with horizontal growth without being overwhelmed by them.

Employee selection and training at Level II depend on the extent to which the MFI uses teams at the branch level. The team structure requires a higher caliber of field staff with the flexibility to learn a variety of responsibilities and who are willing to work as a team member without traditional promotion opportunities. MFIs that are not sure whether the team approach would be conducive in their local cultural environment could introduce low autonomy teams, such as advisory committees and quality circles, as an initial step. This is appropriate because a Level II MFI has probably outgrown the usefulness of informal participatory management styles, yet needs to keep communication channels open so information about customer preferences and trends is available at all levels.

A Level II institution needs to develop leadership and management training curricula to create a cadre of strong middle managers. In most MFIs, the middle manager is typically the weak link in the human resource chain. If Level II institutions recognize this inevitability, they can develop means of strengthening their links before they become weaknesses. This strategy of cultivating internal leadership may prove helpful when the institution has to deal with the succession of senior management as well.

Although the social mission and the founder's vision are still important motivating factors for staff, it may be necessary at this stage to consider introducing other incentives. The first step may be non-financial rewards such as a day-off voucher or an employee-of-the-month salute. Incentives that directly benefit employees' spouses or families are especially powerful. If the motivation from the institution's social mission is wearing off, and if the budget allows, financial performance incentives may also be introduced at this stage to increase the productivity of staff and to heighten their awareness of key performance indicators. Even if a Level II institution does not use financial incentives, it needs to create accountability and responsibility for key performance indicators, perhaps through benchmark comparisons with leaders in the microfinance field. In addition, because the size of the institution prevents senior management from directly supervising lending activities, it is critical that the honesty and trust become engendered in the corporate culture.

The planning horizon becomes longer for Level II MFIs as the institution is better able to predict the outcome of hiring new staff and opening new offices. MFIs at the upper end of the Level II spectrum will probably also increase their investments in research and development so they can prepare themselves for a competitive environment, and can improve the quality of service they offer their clients.

Level III

Once the MFI is comfortable with its basic methodology—if it is achieving excellent results in terms of portfolio quality, customer service, and client retention, *and it is profitable*—it is ready to replicate its model in numerous sites. During this expansion phase, the MFI needs to manage growth by relying on management information systems, self-managed work teams, and middle managers as servant leaders, and by trusting well-trained employees. The significance of an MFI's human resources during expansion reinforces the importance of hiring and training—finding the right people and teaching them the right things—before entering growth mode.

Serious horizontal growth is possible only once an MFI reaches Level III. A profitable Level III institution can leverage its equity to fund a more dramatic growth strategy that is likely to include opening a significant number of new offices. It is important for institutions at this stage to reduce their concentration risk by diversifying their products or markets. MFIs that reach this level today can probably be classified as rule makers, which automatically makes them targets of smaller, but perhaps more innovative competitors. A Level III institution must guard against ostrich management and complacency by continually striving for improvement and ensuring it is meeting the needs of its market. To do so, Level III institutions need to continue—as they have done from Level I—to carefully monitor their market and solicit suggestions from employees who are closest to the clients. It may be useful to establish a research and development department or a cross-departmental team to assume responsibility for ensuring that the MFI remains a learning organization. This structure should help the MFI to meet customer needs in a changing business environment by bringing well-tested new products to the market quickly.

In Level I and II institutions, staff are highly committed to the target population. They are adaptive because they understand that the lending methodology is evolving and they are willing to work toward fine-tuning it. But there is a tendency, once the MFI reaches Level III, once lending methodology works and the organization moves into growth mode, to lose the adaptability edge and to some extent the commitment. The adaptability of the organization must not end once the MFI rolls out its basic products on a large scale. To retain the commitment of its employees, to ensure that it stays ahead of the competition, and to continue to demonstrate its commitment to its customers, MFIs must realize that adaptation and innovation are ongoing processes.

A flat, decentralized organizational structure is necessary to support the horizontal growth of the institution. Business units or branches need to have sufficient autonomy to respond to the unique characteristics of their local markets. Consequently, a Level III MFI requires a strong culture and a widely accepted set of values and priorities, to provide field staff in a decentralized institutional structure with the clarity of vision to assume authority. At the head office, to manage growth the institution may create a shadow management that does not have operational responsibilities and is focused solely on identifying and solving problems associated with growth.

In a smaller business, senior management can demonstrate a genuine concern for the employees, but as the business grows, the personal link between the managing director and the loan officers begins to weaken. When the MFI expands, senior managers need to find ways of maintaining that personal link to motivate staff to perform to the best of their ability. As with many entrepreneurs in growing businesses, the visionary founder may no longer be the right person to manage the large and expanding institution. When the MFI experiences success, and begins to grow exponentially, the institution may need a different set of leadership skills. Instead of a visionary, the MFI may need a

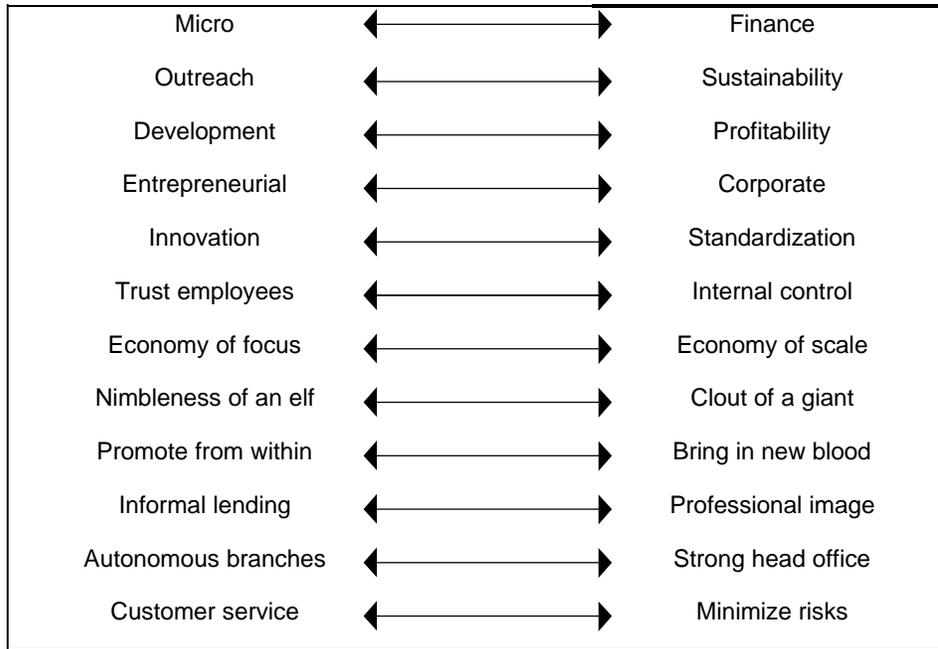
professional manager. This transition from a visionary leader to a professional manager can be traumatic. Only durable institutions can survive the departure of their founders. An executive team can help facilitate succession planning.

At this stage, MFIs need to find ways to integrate themselves into the mainstream business community. For example, they may form partnerships with public policy research groups. These groups may have government mandates to monitor or research key issues in microenterprise development that are closely aligned with the interests of the MFI. This partnership would make it possible to use these research groups to learn more about the demands of the market. Networking through chambers of commerce and rotary clubs is also a useful exercise. A growing company should encourage the widespread involvement of its staff at all levels in industry and professional associations to broaden the perspective of the company and challenge its conventional wisdom. As MFIs move from the development community toward the finance community, they need to make new friendships that reflect their increased scale and significance.

Level III institutions, particularly those that become regulated financial institutions, experience pressures of profitability that may require them to adjust their institutional culture. Although the institution's mission does not change, the way the MFI strives to fulfill its mission may be altered. To remain true to its mission, a Level III institution may rely heavily on its board of directors to serve as the guardian of mission.

Managing growth is ultimately a balancing act. Growing MFIs need to find ways of balancing their micro and their finance. Institutions that move beyond Level III merge their entrepreneurial roots with professional management to combine the best of both worlds. MFIs need to maintain an entrepreneurial approach while achieving the economies of scale available in a large organization. They need to have standard systems and procedures while allowing flexibility to accommodate local demands. MFIs need to trust and value their employees while implementing very rigid internal control policies to minimize fraud. Employees need to present a professional image without distancing themselves from their target market. As shown in Figure 9, in microfinance *managing growth* is the process of balancing seemingly incompatible objectives.

Figure 10: The Balancing Act of Managing Microfinance Growth



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