Weaving Straw into Gold:

Rule Bending, Localism, and Managing Inconsistencies in Organizational Rules[1]

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Abstract

This article explores how microfinance institutions (MFIs) resolve tensions between the creation and the enactment of organizational rules. The study complements rich ethnography with detailed loan data to show that some loan officers frequently bend rules to better address client needs, while others enforce the rules strictly. Differences in enforcement styles are analyzed to explain the structural conditions that generate them. The article shows that officers exercise discretion productively to help clients and improve company policies. Yet, their effectiveness is contingent on being held in check by rule enforcing peers. This is because the same conditions that generate officer discretion also create a fuzzy professional identity. Thus, branch-level interactions between similar loan officers result in "localist" identities decoupled from the firm; while branches with diverse enforcement styles generate professional identities that are integrated with the firm, create amplified learning, and increase the legitimacy of discretion in rule enactment.

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> *One of our main advantages is that we know when to be flexible, we know* ***when to make exceptions*** *for our clients. (…) Our main challenge right now is that we need to* ***become more standardized*** *to control our growth. We have great policies that we developed carefully but they are often not followed that closely. (General Manager, FR)*

Introduction

How do organizations provide services that are both effective and fair?

Since Weber, the bureaucracy as a superior form of organization has been at the heart of sociology. In the ideal bureaucracy, the role of the individual is reduced to an interchangeable position in a structure where rules define actions independent of personal characteristics and relationships (Parsons & Shils 1951; Heimer 1992). Specifically, organizations create rules to lower costs through standardization (Weber 1978), reduce workers' subjective judgment through actuarial decision rules (Dawes 1979; Dawes *et al.* 1989), increase the reliability of organizational performance to handle environmental uncertainty (Hannan & Freeman 1984), codify organizational learning (March 1991), and create fair and predictable career metrics for employees (Maniha 1975; Pfeffer *et al.* 1977). In addition, organizations have external (and internal) constituencies that hey must respond to. Universal, standardized rules are a way to signal a commitment to fairness or minimum standards of care (Lipsky 1980; Spicker 1994; Thompson & Hoggett 1996) as well as to institutionalized values, purposes, and methods (Meyer & Rowan 1977).

Yet, for all the intellectual and philosophical appeal of universalism as a bureaucratic principle, we know this is not how organizations *truly* operate. Since Meyer and Rowan (1977) it has been established that rules are often no more than a myth that organizations espouse to retain legitimacy in the marketplace, while the operational core is decoupled from that myth. Rational myths can be at odds with organizational efficiency, different market expectations can contradict each other within a firm, or the rules can be too general to prescribe action (Meyer & Rowan 1977). Even when rules are aligned with organizational efficiency, close relationships –that circumvent rules—between exchange partners can generate trust, increase mutual commitment, provide nuanced information that cannot be codified, and result in more creative solutions that benefit both sides (e.g. Sabel 1993, 1994; Uzzi 1996). Moreover, especially in environments that present high levels of uncertainty, policies will fail to anticipate all situations, so following rules

closely may result in suboptimal –or harmful—decisions (Blau 1955; Blau & Scott 1962; Lipsky 1980; Taylor 1993; March 1997). More generally, rules are enacted by individuals who exercise agency in their recognition, selection, and implementation to specific situations (Heimer 1992; Emirbayer & Mische 1998; Feldman 2000, 2003; Howard-Grenville 2005). Variation in rule enactment is thus often desirable and mostly unavoidable. Thankfully so, since only experimentation outside of existing practices can lead to organizational learning an innovation (March 1991).

We are thus left with a paradox. Clear, generalized rules are desirable and often necessary for organizational survival. Yet, they are at best unattainable ideals and at worst sophisticated –and costly—pretenses. Organizations must find a balance between these two realities. We generally accept that organizations experience a tension between the rules they (need to) create and their enactment in practice. But this tension, while often described, is rarely explored in depth, so we know little about how organizations *actually* resolve it.

In few industries is this tension more salient than in finance. The image of the local banker who lends based on personal trust is not only pervasive, but also is more effective for some types of lending (e.g. Uzzi 1999; Berger, A.N. *et al.* 2001). At the same time, the consolidation of local banks into corporate giants, the wealth of information available from each client, and the increasing availability of technology to analyze data have all pushed towards the automation of decisions through tools like credit scoring (Bhide 2010). And nowhere within finance are these pressures more visible than in Microfinance Institutions (MFIs).[2] MFIs are inherently labor-intensive, as they provide their services through loan officers that enroll and monitor a large number of small-scale clients (Morduch & Armendariz de Aghion 2005). This, coupled with dependence on outside investors who increasingly expect a set of standardized practices, has pushed MFIs to develop sophisticated tools to increase the reach of their services and become more

[2] In short, microfinance consists of the provision of financial services (mostly loans) to unbanked populations. It allows clients to make small payments with high frequency to better adapt to their economic conditions. Because clients tend to be relatively poor, another distinctive factor is that services are provided with little or no collateral. See: (Morduch & Armendariz de Aghion 2005).

accountable to outside investors while maintaining a relatively nimble cost structure (Morduch 2000). Yet, "soft" information that travels only through personal ties is especially important when lending to small firms given their limited reporting infrastructure, the inherent uncertainty of their business, and the high variance among clients who, on paper, look the same (e.g. Petersen & Rajan 1994; Berger, A.N. *et al.* 2001; Berger, A.N. & Udell 2002). In addition, most of the interactions between MFIs and clients happen through loan officers. MFI loan officers work in settings that mirror Michael Lipsky's "Street-Level Bureaucracies", where employee discretion in the utilization of resources, the management of individual interactions, and the enactment of rules is especially salient (Lipsky 1980; Silbey 1981; Silbey & Bittner 1982). Thus, both as a strategy to improve performance and as a result of the limitations of rules, MFIs can be expected to face significant tension between centralized rules and actual practices.

This paper uses microfinance to show how tensions between rules and their enactment are experienced and resolved. MFIs face intense competitive and institutional pressures that have led them to develop detailed organizational scripts supported by sophisticated technologies. Yet, the complexity of their environment creates a perennial gap between organizational policies and practices. I show that certain loan officers learn to think of organizational rules not as binding constraints but as tools they can use selectively to fulfill their job. They establish strong client relationships to gather organizationally relevant information, which allows them to recognize when company policies misrepresent reality. In such cases, these loan officers diverge from official procedures to better address clients' needs and, in so doing, improve organizational performance. As specific rule deviations show repeated success, they improve existing policies by uncovering some of their shortcomings.

At the same time, while these divergent practices tend to result in superior performance, both their effectiveness and especially their ability to improve organizational rules are contingent on whether they are held in check by rule *enforcing* loan officers. Specifically, in branches with high concentrations of divergent officers, overall performance actually *decreases*. For rule divergence to remain organizationally productive, it requires a

justification governed by organizational validity (Walker *et al.* 1988; Heimer 1999; Zelditch 2001; Johnson, C. *et al.* 2006). Yet, the same organizational conditions that grant discretion and responsibility to loan officers also create a fuzzy professional identity with a fragile organizational standing. As a result, loan officers define their professional identities within their local branch, through interactions with clients and, more importantly, with each other (e.g. Gouldner 1964; Bearman 1991; Hallett & Ventresca 2006). These identities define how loan officers relate to organizational rules, beyond their personal enforcement style (Stryker 1994). Therefore, while branch-level interactions between similar loan officers often result in "localist" understandings of their role in the firm; branches that contain diverse enforcement styles generate professional identities that are more integrated with the firm, resulting in amplified learning, better use of loan officer discretion, and increases in the legitimacy –and effectiveness—of divergences from rules.

This study thus documents that divergent and compliant practices within organizations are not merely a degenerate of the other, but rather are forms that coexist and depend on one another. It also suggests that the tensions inherent in organizational rules will be especially salient for organizations that must rely on field worker discretion, like street-level bureaucracies (Lipsky 1980). While some organizations may rely on the professions to guide individual action, many organizations must employ workers who, like microfinance loan officers, must exercise discretion yet don't have the professional training or status to guide it. In such cases, similar tensions and dynamics will emerge. The paper is structured as follows. First I provide a brief review of the relevant literature to frame the paper's contribution. Second, I describe the data and methods. In the third section I use the qualitative data gathered through months of fieldwork to generate a series of propositions that are then tested using loan level data. These analyses provide insights into the mechanisms behind the observed patterns, which are discussed in the final section of the paper.

The Theoretical Problem: Rules Simultaneously Address and Contradict Organizational Needs

Organizations need rules. Rules are the formal representation of organizational routines and thus store organizational knowledge and capabilities (Levitt & March 1988; March 1991; Argote 1999). They promote standardization, the reduction of complexity, and efficiency (Weber 1978; March 1991; Cohen *et al.* 1996). Rules allow bureaucracies to create order and predictability by determining how categories of interactions are to be treated, thus clarifying obligations and rights (Heimer 1992). Without rules, workers may treat customers erratically and fail to provide equal levels of service; they may have difficulty claiming rightfully earned rewards if there is no objective standard to chart their progress (Maniha 1975; Pfeffer *et al.* 1977); or keep procedural conflicts unresolved (Nelson & Winter 1982). Furthermore, even the most skilled workers are subject to cognitive biases, lapses of judgment, and inconsistent decisions that can be avoided through data-driven decision rules (Dawes 1979; Dawes *et al.* 1989). Aside from these functional purposes, organizational rules are as much guides as they are justifications for action. Organizations have external (and internal) constituencies that they must respond to, and rules –regardless of their actual effectiveness—demonstrate commitment to certain values, norms, and standards of care as well as to institutionalized goals, methods, and regulations (Meyer & Rowan 1977; Lipsky 1980; Edelman 1990; Edelman *et al.* 1999).

A central tenet of organizational rules is universalism: rules should be defined according to general standards, independent of individual characteristics or relationships (Parsons & Shils 1951). Put differently, bureaucracies produce rules that regulate how categories of actors should be treated, and *everyone* within a category should be treated the same way (Weber 1978; Heimer 1992; Spicker 1994; Thompson & Hoggett 1996). Generalized rules dominate because they are simpler, easier to formulate, cheaper to monitor and enforce, and easier to justify to external constituencies. Yet, these attractive characteristics create the rules' inherent limitations. The design of any rule entails a set of (stated and unstated) assumptions about a set of categories and how actors fit into those categories (Taylor 1993; Spicker 1994; Habermas 1995; March 1997). While there may

be many instances where assumptions rightly describe the situation, there are others where they will fail to capture relevant variation. In such cases, the application of a rule that seeks to be fair by treating all actors equally may in fact result in unfair, unethical, or unfavorable results as we may seek irresponsible fairness “based on equal *ignorance* of all those whose fates we might affect” (Heimer 1992: p.152, emphasis added). Ironically,

> Modern bureaucracies gain legitimacy by (often rhetorical) commitments to standards of fairness and equity. But (they) are constantly confronted with the apparent unfairness of treating people alike (Lipsky 1980: p.22).

The predictability, accountability, and order associated with rules thus have inherent limits precisely because they cannot –*should* not—account for differences across actors. Transactions don’t happen in a void, they consist of interactions between individuals situated in networks and bound by the obligations and role expectations of network partners to one another (Blau 1955; Gouldner 1964; Heimer 1992). Because rules must remain abstract, they cannot possibly anticipate all the instances where they are to be applied (Wittgenstein 1968; Taylor 1993). Moreover, even if rules are well specified they are still enacted by specific individuals who will use their past experiences and their thoughts on the future implications of their actions to recognize, locate, and implement the policies that they deem relevant in the manner they deem appropriate (Emirbayer & Mische 1998). Put differently, inside each organizational rule lies a tension between its definition and its actual enactment, or between what Feldman and Pentland (2003) describe as its ostensive and its performative aspects.

It follows that the gap between a rule and its application does not necessarily arise from poorly designed policies but from the vary nature of organizational rules. Since the tension created by this gap cannot be removed –only reduced—simply by improving the quality of rules, organizations may address it through a flexible application of policies. Employees will have an interest in maintaining and expanding autonomy, as managers strive to strike a balance, honoring such autonomy as long as it is matched by performance (Lipsky 1980: p. 19, 25, 50).

That organizations reside in a world where rules are less than perfectly followed is, of course, well known. It is no surprise, for example, that organizations often adopt rules solely to comply with the symbolic demands of external constituencies and institutions. Since those symbols may be misaligned with actual operational realities, or may provide ambiguous or conflicting prescriptions on how to comply with them, organizations will purposefully decouple operations from outward-facing rules and will create routines –or status hierarchies—to relieve internal inconsistencies (Meyer & Rowan 1977; Edelman & Suchman 1997; Heimer 1999).

Rules are also bent for reasons other than decoupling or mischief. Network ties that leverage personal relationships can generate deeper levels of trust, provide valuable information that cannot be included in rules, promote joint problem solving, and increase mutual commitment (Sabel 1993; Uzzi 1996; Ingram & Roberts 2000). Organizational actors thus routinely diverge from established rules to meet the demands of their work, often with their managers' consent. This is especially true when occupations entail intense interactions with people, the service entails a long-term contract between customer and provider, or the objects of decisions –people—may change as a result of a decision (Lipsky 1980; Heimer 1992). But even in settings where personal relationships play a less prominent role we know that "embedded" ties that circumvent policies can result in improved organizational performance (Baker 1984; Piore & Sabel 1984; Sabel 1994; Uzzi 1996; Ingram & Roberts 2000).

Finally, different actors simply have different interpretations of rules, especially in complex situations where policies provide incomplete or contradictory directions (Edelman 1992; Emirbayer & Mische 1998; Heimer 1999; Feldman & Pentland 2003; Howard-Grenville 2005). Differing interpretations may stem from an actor's limited understanding of rules, but they also may be based on a *better* understanding of the rules and what they are trying to accomplish (Feldman 2004; Author 2011; Silbey *et al.* 2009; Piore 2011). Even when divergent interpretations are accidental or unwanted, they can still constitute a valuable source of organizational learning and change (March 1991; Feldman 2004; Erikson & Bearman 2006).

We thus generally accept that variation in rule enactment within organizations is not only unavoidable but also desirable. Within this acceptance lies the assumption that successful organizations somehow strike a balance. In fact, this gap between general prescriptions and actual decisions is akin to the basic dilemma of any profession. In fact, the need to use discretion for technically complex decisions is precisely what defines a profession. To support and guide decisions, each profession creates a host of training, certification, and membership mechanisms, not to mention status structures to protect members. These mechanisms signal how discrepancies should be resolved within the profession and allow members to retain exclusive claims to certain tasks (Abbott 1981). Organizations, however, face a more complex version of the dilemma.

Professionals inside organizations sometimes do use their expertise and status to resolve discrepancies or contradictions in existing prescriptions –not without contestation (e.g. Edelman *et al.* 1999; Heimer 1999; Dobbin & Kelly 2007; Dobbin *et al.* 2011). But it is unclear how to resolve them, for example, when no profession has clear ownership over a contested issue or no actor has relevant professional training to draw upon. To complicate things more, the actors who define the rules are often far removed–physically and occupationally—from those who enact them. We thus anticipate that many workers will (have to) break some rules, that they will lack the professional norms or institutions to guide them, and that results will vary considerably. The (managers within the) organization, for its part, must evaluate instances when rules are broken, manage the internal conflict that arises from them, and find ways both to limit those instances and channel their results productively. Moreover, given that organizational survival depends on how knowledge is adapted and routinized, a failure to resolve them successfully can have drastic consequences (March 1991). Recent events in financial companies from Enron to the mortgage crisis provide vivid examples (Bhide 2010). Yet we know very little about how this complexity is *actually* managed and, more importantly the conditions under which it is resolved productively.

The question requires an approach that does not take written rules as unproblematic but rather uses them as the level of analysis, unpacks them, and treats rules and practices as endogenously related and frequently decoupled (Ewick & Silbey 1999; Feldman 2000; Feldman & Pentland 2003; Pentland & Feldman 2005; Silbey 2005). But it also requires us to straddle levels of analysis and move beyond the enactment of rules to study how organizations aggregate and manage those rules, especially in settings where actors have fewer guidelines –from the professions, for example—to guide their choices.

The Setting: Microfinance in Mexico

Microfinance Institutions (MFIs) emerged to provide underprivileged populations with formal financial services and replace loan sharks, informal savings groups (ROSCAS), or politically compromising government programs. The rationale is that capital is a binding constraint for most of the poor, so granting them access to efficient liquidity sources can allow them to work themselves out of poverty (Morduch 1999). As NGOs, initially MFIs could rely only on donors to fund their growth (Marulanda & Otero 2005). This generated a dual pressure –from their dependence on donors and the need to find internal sources of growth—to adhere to strict norms of profitability and narrow their focus to microcredit, the most profitable of their services (Dugan & Goodwin-Groen 2005). It also created the need to systematize lending practices and to generate detailed financial information –and the managerial systems that support them—to appeal to donors (Morduch & Armendariz de Aghion 2005). With the success of increasing numbers of MFIs, private investors flowed in bringing heightened market awareness and, given the focus on lending activities, increased regulatory oversight.[3] An illustration of the pressures to conform is the number of international organizations that tracks MFIs around the world and provides periodic reports on best practices and benchmarks.[4] Investors and donors have come to rely heavily on these benchmarks to judge potential investments and demand that MFIs adopt similar lending structures across markets (Dugan & Goodwin-Groen 2005).

[3] A recent, visible example was the successful IPO of Compartamos, a Mexican MFI that raised over US$400M in 2007.
[4] See www.mixmarket.org and www.accion.org --two prominent examples.

The pressures are more than symbolic. Investors, for example, expect MFIs to match standardized metrics of operational efficiency. The drive to reach as many poor clients as quickly and as cheaply as possible has led MFIs to develop advanced technologies to rapidly expand their services while reigning in costs. These tools include sophisticated credit scoring models, statistical tools to track client behavior, and hand-held devices that loan officers can use in the field to access information in real time. This is especially relevant because MFIs are inherently labor-intensive, as they serve mostly remote populations of atomized, small clients who can only be reached by individual loan officers (Morduch & Armendariz de Aghion 2005). Thus, the benefits of technological advancement, standardization of lending standards, and increased operational efficiency always run into deeper organizational realities.

Loan officers represent the sole point of contact between clients and MFIs. Their discretionary actions determine both the access that a potential client will have to a loan and its conditions. This is especially critical for poorer, more excluded clients. In addition, loan officers must manage the clients' reactions to the firm's decisions and thus operate on a constantly shifting ground. While the major dimensions of work –lending policies, incentive schemes, collection rules—are centrally defined, loan officers operate in situations that often require responses on dimensions that cannot be codified in formal rules, such as gauging the moral character of a client with no financial records. Yet, for all the complexity of their work, loan officers are usually inexperienced and have no professional training (see also Author 2011). As discussed above, actors in such settings must exercise great amounts of discretion in the application of rules (Lipsky 1980). Yet it is precisely this discretion that is curtailed through standardization.

Given the localized nature of microfinance, the large differences that exist across contexts, and the role that loan officers play in the lending process it is unlikely that internationally defined rules can be enacted without slippage. Nevertheless, most of the "orthodox" studies that drive international best practices focus solely on the formal aspects of MFIs, like their contractual structures and collection policies (Mosley & Hulme 1998; Pitt & Khandker 1998; Mosley 2001; Khandker 2003; Pitt *et al.* 2003;

Morduch & Armendariz de Aghion 2005). As a result, they use the organization as the level of analysis while neglecting field-level practices. To the degree that there is a gap between the ostensive and the performative component of MFI policies, a sole focus on the written rules can both miss important variation contained in diverging (actual) practices, as well as ignore the endogenous link between current practices and future rules.

Mexico is a particularly fertile setting for several reasons. While the explosion of microcredit in Mexico has followed a similar trajectory to other geographies, the Mexican microcredit movement is estimated to have emerged with a ten-year lag with respect to other Latin American countries (Christen 2000).[5] As a result, when microcredit took hold in Mexico, a relatively narrow set of international best practices had already emerged with specific expectations for a "legitimate" MFI. In addition, the financial crisis of the mid 1990s affected both liquidity levels and the confidence of Mexican investors. Thus, Mexican MFIs were especially dependent on foreign donors and experienced additional pressure to conform to international standards (Marulanda & Otero 2005). At the same time, the large amount of market and regulatory uncertainty that MFIs encountered in the Mexican market created a strong discrepancy between donors' expectations, formal rules and goals, and actual organizational needs (Alpizar & Gonzalez-Vega 2006). This discrepancy put in full relief the existing contradictions that exist in all MFIs but that became more salient in the Mexican case (Villafani-Ibarnegaray & Gonzalez-Vega 2006).

Data and Methods

I performed a mixed-method analysis of three MFIs in Mexico to explore the relationship between organizational rules, loan officer practices, and client behavior. I placed a particular emphasis on qualitative methods, following a grounded theory-building approach (Glaser & Strauss 1980). I explicitly straddle different levels of analysis, going from organizational policies, to branches and branch managers, to actual interactions between loan officers and clients. The research design first seeks to understand within-

[5] This lag is tied to specific institutional constraints of the financial sector as well as the instability that defined the "lost decade" of the 1990s in Mexico (Alpizar & Gonzalez-Vega 2006; Author 2008).

firm variation and then look for patterns across MFIs. The choice of specific MFIs reflects this strategy. I worked with one company (FL) that works mainly in the urban sector mostly with an individual lending methodology, another (FR) that works mostly in rural sectors with a communal methodology, and a third (CG) that works both in rural and urban settings and that mixes group and communal lending (see table 1).[6] Even though the companies have different structural characteristics they are all profitable, have been so from their origins, and have been recognized by international organizations as leaders with orthodox practices. For example, all companies follow lending systems that gradually increase loan amounts as clients demonstrate their ability to pay; all companies have variable compensation schemes for loan officers that track similar (identical, in fact) business metrics; all companies have detailed, well-documented credit manuals; and all of them rely on their branches and loan officers for lending decisions.

INSERT TABLE 1 ABOUT HERE

I spent over five months collecting qualitative data within these companies, and several more doing routine follow-up interviews. A majority of the time was spent with FL, where the initial findings emerged. I repeated the methodology extensively with FR, and CG was used as a validation case. Within each company I followed a similar process where I conducted semi-structured, ethnographic interviews with MFI employees, starting with the CEO and working my way down the organization until I reached loan officers. I also sat in numerous internal meetings as an observer. I asked interviewees to place branches in three groups: good, average, and poor performers. The categorization was highly consistent across employees within each company, and I corroborated it with company reports. I then randomly selected between one and three of the branches from each group for each of the companies. I spent a day visiting each branch, talking to the

[6] There are three basic lending methodologies in microcredit. Communal banks (the most widespread) require groups of twenty to fifty clients to come together and collectively apply for a loan. The group is self-regulating and members are collectively responsible for the repayment of the loan, even though smaller loans are distributed to each member of the group. Solidary groups are smaller groups, of three to five, and are also collectively responsible for loan repayment. Here the loans are given directly to the individuals as opposed to the group and the groups are not self-regulating; each client undergoes a separate credit analysis and interacts with the MFI separately, but the group acts as "social collateral". Individual loans are self-explanatory.

manager, attending committee meetings and observing manager-client and manager-loan officer interactions. At the end of each branch visit I selected a random sample of loan officers with the assistance of the branch manager.

I spent one to two days shadowing each loan officer on her route. I observed their interactions with clients, their lending and collecting practices, and I asked them to narrate their actions after they had occurred.[7] I interviewed just over 60 employees. Finally, I performed client interviews. I asked each loan officer to give me a list of her clients and I randomly selected between three and five. I asked officers to signal their best clients and their worst clients and to include program drop-outs --clients who were no longer in the system.[8] I performed over 50 client interviews. For all my qualitative work –interviews and observations—the data were collected and coded by hand. I went through all the field notes and interview transcripts to identify recurring themes and their emerging categories. Then I identified specific routines to analyze differences between the formal policies and their enactment (for example, around loan delinquency) –as mentioned, I focused on within-case patterns before comparing across cases (Miles & Huberman 1994).

Once a clear set of patterns emerged from the field data, I tested them using two of FL's databases. The first is a comprehensive dataset of all the loans provided by FL between 2000 and 2008, with quarterly observations on the performance of each loan. The database contains 450 thousand loans grated to over 60 thousand clients. Each observation contains loan size and characteristics, the responsible loan officer, interest rate, payment behavior, as well as individual information on each client and her business. The second is a database of the performance bonuses paid to all loan officers between 2000 and 2008. In the three companies I studied, loan officer compensation consists of a fixed and a variable component (more details below). I combine these two databases to

[7] For example, after a loan officer performed a credit analysis, I would ask her to describe the process she followed. If details were left out from her account I would ask her to clarify, for example "why did you ask the store owner how many dairy suppliers he has?"

[8] A shortcoming in most microfinance studies is that databases are naturally censored: MFIs only collect information on existing clients. It is impossible to determine whether clients dropped out for good (they need larger loans) or bad (they have become over-indebted) reasons.

analyze the relationship between loan officer practices, loan officer performance, and client (loan) behavior. Table 2 presents a list of the variables used, a brief description of each, and some basic statistics.

INSERT TABLE 2 ABOUT HERE

Empirical Evidence: How MFIs Manage Rules

MFI Policies and Performance Differentials

How much do practices vary within MFIs? Current wisdom in microfinance suggests that practices should be highly standardized to achieve financial control, equality of service, and cost reductions. At the most basic level, standardization addresses the need to create strict lending standards and control mechanisms. For MFIs, this translates to the creation of detailed credit manuals, operating procedures, training programs, accounting and management systems, and statistical tools for actuarial judgment; most of which follow international best practices.

> Our branches should be like franchises (…) Our clients should know that, regardless of which branch they go to, the same standards (of service and credit analysis) will apply. (CEO, FL)

The need for standardization also reflects the high-cost nature of microfinance, where the amounts are so small that many loans are required to create economies of scale:

> Skeptics of microfinance argue that it costs as much to lend one million than to lend one hundred. They are only partially right. In fact, it costs much more to lend five (…) There is no way we can follow a traditional lending model, the costs are just too high. Without automation (…) of decisions, we are doomed to fail. (General Manager, FR)

Cost pressures combine with increased competition and external oversight, as the CEO of FL explained:

> Every month, as soon as MixMarket updates its metrics (on all the MFIs that report results) I start getting calls from investors (…) It was a nightmare when Compartamos issued its IPO prospectus (with all their cost information), we spent weeks justifying the cost differentials (…) (Our investors) expect us to be the leaders, to have the best technology to reduce costs and track clients.

These pressures for standardization, however, inevitably run against the nature of microfinance, where every transaction happens between loan officers and clients who have little experience with the financial sector, have little verifiable financial information, and live under enormous economic uncertainty (Morduch 1994; Morduch & Armendariz de Aghion 2005). Consider these conflicting statements from a manager at different points of the interview:

> A key challenge that we often face is that our policies can be too rigid; they don't allow us to capture all client needs and situations. We strive to adapt as much to those needs as possible (…) so loan officers must make sure that they are fair, and this is especially important when clients are in trouble and things (according to the rules) could end up damaging them.

Later in the interview:

> We need to be more disciplined. The branch managers need to enforce the policies because otherwise all loan officers decide outside of the margins.

A similar contradiction occurred during the conversation with FR's general manager:

> One of our main advantages as a company is that we know when to be flexible, we know when to make exceptions for our clients, we know when they need help. (Later in the interview) Our main challenge right now is that we need to become more standardized to control our growth. We have great policies that we developed carefully but they are often not followed that closely.

In fact, *every one* of my twenty manager subjects showed this contradiction between the need for standardization *and* the need for customization as key challenges within their interviews.[9] During a follow-up interview, one of the managers explained the tension well:

> When you go to Starbucks, for example, you can order your coffee *exactly* as you want it (…) but Starbucks is a completely standardized company. You *feel* like you are getting a customized product, but you are not (…) You cannot order strawberry Quik. The difference is that for them it is easy. There are only so many variables that can be tweaked. In microcredit the variables are endless, so no matter how hard we try, we can never fully standardize our operations. Our customers *really* need strawberry Quik sometimes, and it may be in our interest to serve it to them.

These conflicting pressures lead to an inherent contradiction. Just as the firms develop increasingly sophisticated policies, many decisions are left to field agents:

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[9] These statements were not responses to specific questions about organizational rules or practices. They were given in the context of questions about general challenges or competitive advantages.

> They have procedures to guide them, but at the end of the day (branch managers) determine what happens at their branch, they are the bosses there (…) and they must understand the importance of loan officers (…) who are the bosses of their clients' performance. (Risk Manager, FR)

The clearest reflection of field-level discretion is that, despite the "franchise" aspirations of managers, branches within the same firm display large performance differences that are not explained by market, geographic, or economic factors. Table 3 presents a representative sample of FL branches with some key performance metrics. It shows significant variation across branches on relevant metrics like delinquency rates, portfolio growth, and loan impact –measured as increase in average household income between loan cycles. Notice, however, that these results are not driven by differences in client wealth –the correlation between income and performance goes in the opposite direction that we would expect. Consider also that branch numbers are assigned according to regions, which means that branches 25 and 26, or 31 and 32 are actually situated in close proximity to each other with substantial overlap in their coverage areas. Geography, therefore, is not driving the results either. In fact, all MFI employees attribute differences to branch-level practices. Not a single interviewee attributed them to external factors.

INSERT TABLE 3 ABOUT HERE

In particular, employees recognized loan officers as the critical component. Loan officers are the primary point of contact with clients. They recruit and evaluate clients, which entails visiting them in their home of business. Once there, officers should gather –and verify when possible—relevant credit information including family income, business and household expenses, and credit references. They also are expected to perform a credit analysis, produce a credit recommendation, and run it through the branch credit committee. If the loan is approved, the loan officer informs the client (or group) and provides all the necessary information for the disbursement of the loan. Once a loan is disbursed, the officer supervises its repayment. Should a client miss a payment, loan officers are expected to ensure collection through a progression of increasingly intense strategies. When a loan reaches maturity, the officer is expected to renew it –ideally increasing the amount—for clients in good standing. In addition, the loan officer is

expected to "sell" other products like home insurance to the client. On top of all client management activities, loan officers must participate in credit committee meetings, provide daily updates of their clients in the MFI's systems, and train incoming loan officers. It is a complex array of activities that is performed in remote areas, often requiring average daily commutes of four hours or more.[10]

It is precisely the importance, intensity, and complexity of loan officer work that has led MFIs to develop increasingly sophisticated tools. Credit manuals, for example, set clear policies on the size of new loans as a multiple of client cash flows (for individual loans) or saving capacity (for group loans); potential loan increases as a function of repayment behavior; collection procedures as a function of missed payments; or eligibility for new products. These policies have been standardized and automated to the point that loan officers carry handheld computers where they can input a client's information and, in real time, obtain a policy prescription for the situation. The same complexity that led to these policies, however, also grants discretion to loan officers on whether, when, and how to enact them:

> (Managers) here will tell you that officers work with the company's technology, which gives you the terms of loans and tells you whether or not to give a loan and for what amount according to certain liquidity measures. But (it is the officer) who gives out the loan. You can manipulate the machines and policies. You go through the entire analysis process and, at the end, if you trust the client and believe in her, you give her the loan. Maybe the liquidity index will not be enough according to (the rules) but if you believe in her, you will help her out and you will take the risk with her. (Loan officer, FR)

Not surprisingly, managers are aware of this use of discretion. All rules are often questioned, bent, or broken by loan officers with the endorsement of their managers – with the exception of corrupt or dishonest behavior. Discretion thus works both ways: officers know that they can use discretion and company managers choose to keep it that way. It also takes on both meanings: managers are discrete about loan officer discretion, as they know it benefits the firm but it should not be advertised. This occurs even in the most analytic parts of the process:

> Take our credit scoring models, for example (…) we treat them as trade secrets. We discuss them in board meetings, and we show our technology to our investors and they love it. Do our loan officers stick to them one-hundred percent? Of course not! Look at

[10] See (Author 2011) for more details.

> our credit manuals. They supposedly provide answers to every possible question you could have. But in reality the field is not like this office, it is messy and difficult to interpret. Our loan officers (…) change a number here or there, they cut a corner once in a while (…) But we don't need to advertise that (…) As long as they are bringing in and keeping good clients, it is all good. Those guys need to do their job. (Credit Director, FL)

Even though divergence from rules is often endorsed by management, it is distinct from mere decoupling in several ways –although decoupling also occurs (Meyer & Rowan 1977). First, notice that the discrepancy between written policies and actual practices is not circumscribed to rules that were adopted as "myths and ceremonies". Rather, it is found in rules that constitute the very core of the organization, were created as responses to salient operational challenges, and seek solely to improve efficiency. Second, loan officers are expected to comply with rules and this expectation is clearly communicated through training courses, internal communications, and each time a policy is introduced. It follows that, in fact, not all loan officers use discretion equally.

Performance and Loan Officer Enforcement Styles

In the observation of loan officers I found that certain loan officers systematically bend rules while others adhere strictly to them. I thus inductively developed a typology, which will guide the rest of the paper. Table 4 shows examples of different rules and how the two types enact them. Naturally, it is not the case that *all* officers can be defined by one type. Rather, each category is one extreme in a continuum. "Spirit of the Law" (SL) officers tend to have a flexible interpretation of the rules. They see them as tools, not binding constraints. To complement what they see as (necessarily) imperfect policies, they establish personal relationships with their clients to know as much about them as possible. They share personal information, discuss the state of the business, ask for referrals, and often provide business advice. Similar to government officials who are embedded in their contexts (Evans 1995, 1996; Ostrom 1996; Lam 1997), SL officers are embedded with their clients, speak their language, and have developed a personal stake in their welfare. This is not out of altruism, but because they are convinced that this is required to do their job well. In contrast, "Letter of the Law" (LL) officers tend to follow rules and do things by the book. To deal with the complexity of their work, these officers let the policies limit the choices for them. They choose to be bound by the rules, not

because they don't think they can bend them, but because rules reduce the uncertainty they face when making consequential decisions. They assume that knowledgeable people made the rules, so they do not feel authorized to question them (see also May & Winter 2000; May & Wood 2003; May & Winter 2009). LL officers remain distant to their clients, not out of contempt but because they believe it is necessary to retain objectivity.

INSERT TABLE 4 ABOUT HERE

To validate my typology –and use it in subsequent analyses—I presented it to the three regional managers who supervise branch managers and loan officers at FL. These mangers interact with loan officers intensely and they know all of them well. In separate sessions with each manager, I went through the entire list of loan officer names and I asked the manager to code each loan officer as "Spirit of the Law", "Letter of the Law", or undefined in cases where it was hard to place them. As primer, I only showed them table 3 and stressed that the types only referred to enforcement styles and had nothing to do with performance.[11] Inter-rater reliability was just below 80 percent. There was no instance where one manager coded an officer as SL while another coded her as LL. The only discrepancies were between a type and an undefined coding. These discrepancies were treated as undefined. Each type accounted for about a third of the loan officer population.[12]

Different as the behaviors across types may be, they are actually driven by the same motivation: to do a good job under extreme uncertainty. SL officers manage the uncertainty by gathering "soft" information from their clients to enhance their judgment. LL officers manage it by deferring to the rules and the hierarchy. These differences are evident in all interactions with clients, but they are displayed in full relief when a client misses a payment. A loan delinquency is a discrete event that must be documented and is clearly specified in the policies. Loan officers are expected to collect the loan following

[11] Two things are worth mentioning. First, after clarifying the typology, the managers thought it was both descriptive and intuitive. Even though they had never coded loan officers this way, it made sense to them. The second and most remarkable is the speed with which the managers could code the officers. It typically took them less than one second to place an officer.

[12] Of 711 loan officer /quarter observations, 235 are SL, 233 are LL, and 243 are Undefined.

contractual terms.[13] Yet, while all missed payments look the same on paper –and clients give similar explanations for them—some loan officers choose to collect the loan as prescribed by the policies while others choose to engage in negotiations and problem solving with the client. The choice depends, most importantly, on the loan officer's reading of the reason behind the delinquency.

In general terms, if you lend me money and I don't repay you on time, then I have signaled that I am not trustworthy, so you should recover as much of the loan as soon as possible and not lend to me again. In microfinance, however, the signal can be much noisier. It can reflect low credit worthiness, but it can also signal a contingency that left a poor client with no choices (Morduch 1994; Collins *et al.* 2009). If this is the case, then an aggressive collection attempt may weaken the client's floundering economy further, eliminating the possibility of future collection. Loan officers, therefore, can have drastically different reads of the same signal. A representative SL officer explained:

> If your client is in a bad situation (…) and you don't find a solution for her, then you can turn good clients into bad ones. (…) Whenever my poorer clients tell me they can't make a payment because something bad happened to them, I have a policy of always trusting them (…)I can tell you that of every ten clients I have helped, nine have made it and eight have become long-term clients. A restructuring is a great opportunity because you develop a double commitment with your client. (SL officer)

Contrast this with a representative LL officer's interpretation:

> Clients are always trying to take advantage of the firm. They tell you stories of why they can't pay their loans, and they are usually good stories. The last thing these people need is leniency, you have to be tough with them, you have to pressure them until they pay even if it is out of exhaustion. The policies are very clear on this. (The clients) signed a contract and they must abide by it. Otherwise they all learn that it is OK not to pay and other clients can see this and do the same. (LL officer)

During my observations, SL officers overwhelmingly chose to negotiate with clients who missed a payment while LL officers mostly chose to collect or send in the collection department.[14] In fact, between 2002 and 2008 a total of 578 loans were restructured through negotiation. SL officers restructured more than half of those loans, while LL

[13] This might entail seizing an asset or collecting through the pressure of cosigners. For group or communal loans it usually entails collecting from the rest of the group and even cancelling the communal line.

[14] Loan officer days typically include visits to between one and three delinquent clients or groups. I was thus able to observe many of these interactions.

officers only accounted for 100 restructurings. From each officer's perspective, however, the goal was simply to achieve a better business performance. Delinquency rates are the most highly weighted element of an officer's bonus and it is usually the first thing that managers look at when assessing loan officer performance. So, when SL officers go out of their way –sometimes sidestepping policies—to help a client, they are not being altruistic. In fact, they are not equally "lenient" with all clients and their collection strategy is not based on compassion but on a different interpretive frame.

Client interviews –especially with clients who dropped out—revealed that the most common cause for missed payments is the clients' vulnerability to external shocks. Poorer households are more sensitive to contingencies due to a lack of assets, savings, or support structures to absorb a negative shock (e.g. Morduch 1994; Alderman 1996; Coulombe & McKay 1996; Czukas *et al.* 1998). All clients face shocks, naturally, but the more destitute have much less to hang on to, so even small contingencies –a child's illness, for example—can send them on a downward spiral.[15] Loan officer discretion, however, can be determinant. In cases of clients who missed payments after a negative shock and the loan officer chose to support them through a restructuring or a contingency loan, they were often able to get back on their feet. In contrast, when a loan officer met a client's contingency by seeking to collect the loan, she just pushed the client further down a spiral. Loan officer discretion thus becomes especially important for poorer clients. Putting pressure on a good but troubled client often only leaves the option of informal moneylenders who can –and almost always do—create disastrous effects.[16] At the same time, the poorer the client, the harder it will be to codify her information in company policies, and the less guidance that a loan officer will have to make decisions. Moreover, microloans have a much larger impact on the lives of poorer clients, who are

[15] We can think of shocks as following a stochastic process where all clients have the same probability of experiencing one. Poorer clients, however, have less tools to deal with it so the observed outcomes are much worse. In fact, the more destitute are more likely to experience negative shocks *and* are disproportionately affected by them.

[16] Clients take out loans to pay other loans. Since they are not investing in productive activities, they become entangled in a trap. As an illustration, consider two women who started with loans of $50 and, after some productive loan cycles they became entangled in a debt spiral. One owed $50,000 and the other $25,000. The MFI's credit analysis determined a debt capacity of $300 for each, which should put their outstanding debt in perspective.

thus more likely to demand –explicitly or implicitly—a higher level of customization (Lipsky 1980; Heimer 1992; Bearman 2005).

In that sense, SL officers who may seem lenient when a payment is missed may simply have more information to interpret an otherwise noisy signal. They could be using their personal relationships with clients to gather that additional information. Given that a set of boundaries –social, economic, cultural—exist between clients and the MFI, policies may miss important elements that can be relevant, especially during atypical situations like an exogenous shock. SL officers construct bridges across those boundaries:

> Officers are information brokers. They have information on each of their clients and sometimes of the people the clients know. They can use that information to determine the moral and economic solvency of new prospects, to detect when a client is in trouble, and to be more affective when they need to collect (…) they have seen what works and what doesn't (…) They know who does what and who know who. When officers use that information to benefit a client, they can truly make a difference. (Regional Manager, FL)

Organizational Benefits from Rule Divergence

For an observer, whether SL officers are being too lenient or are using their discretion wisely can only be determined by the results of their actions. SL officers are convinced that helping good clients when they are in need increases their commitment and long-term profitability. LL officers believe that allowing clients to renege on a contract creates moral hazard problems. Yet, of all the loans that have been restructured, 90 percent have been repaid and 46 percent of those clients remained in good standing in subsequent cycles. In contrast, only 43 percent of loans sent to the collection department were collected and none of those clients remained with the firm. More detailed analyses further reveal the effects of enforcement differences.

Table 5 presents results from a series of multivariate analyses on loan repayments. The dependent variable is whether a loan became delinquent during a cycle.[17] All models include branch and year effects to control for regional and broader economic factors. I used a logistic regression given the nature of the dependent variable. Model I shows the basic controls –kept in all subsequent models—that point in the expected direction. It also

[17] It is a dummy variable that takes the value of one if a client missed any of her scheduled payments. Similar models were run using the total number of missed payments and loan defaults as dependent variables. The results were robust to different specifications.

shows that both LL and SL officers tend to achieve lower delinquency rates than the omitted undefined officers (more on this later). At the same time, LL officers present slightly lower rates than SL officers but the difference between the coefficients is not significant. To put these results in perspective, the baseline average likelihood of a client missing a payment during a cycle is 34 percent.[18] A loan managed by a LL or SL officer has a decrease of 12 percent in the odds of becoming delinquent than one managed by an undefined officer (holding everything else constant at their means).[19] This lowers the likelihood that a client will miss a payment to 30 percent for both types.

INSERT TABLE 5 ABOUT HERE

Model II explores this more, analyzing the probability that a client will miss a *second* payment *conditional on missing a first.* Interestingly, even though the probability of a client missing a first payment was roughly equal for both types of officers, SL officers seem to have a much better ability to put their clients back on track. The average probability of a second missed payment for delinquent clients is 49 percent. Notice that, while the coefficient for LL officers is insignificant, SL officers lower the odds of a second missed payment by 40 percent, bringing the probability down to 35 percent.[20] This suggests that, once a contingency occurs, SL officers are better at managing it than other officers. The same can be seen for loan restructurings. Model III –which once again uses basic delinquency as DV—shows that, as could be expected, a restructured loan is much more likely to become delinquent.[21] In fact, the odds of a delinquency for a restructuring performed by a SL officer are 121 percent larger (50 percent probability) than non-restructured loans, but this is much smaller than the increase in odds of 210 percent (62 percent probability) for the other officers. Similar results suggesting that SL officers *manage* clients better than LL officers hold for other dependent variables –not

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[18] That a third of all clients miss a payment within a cycle may seem high. Consider, however, that this is only a missed payment, not a loan default. Running the models with defaults generates similar results, but missed payments present more variance and they reflect client management that *avoids* a default.

[19] As a reminder, coefficients in logit regressions represent changes in the log-odds of observing an event. To facilitate interpretation, I am calculating the change in odds and the implied change in % likelihood.

[20] Notice that this effect is independent of loan restructurings. This trend is continued for additional missed payments and defaults.

[21] A client may still experience difficulties even after a loan was restructured. Consider from model I that a restructured loan has an increase of 300 percent in the odds of a delinquency, or a probability of 59 percent.

shown here for brevity—such as loan renewals and loan amount increases, even when including client fixed effects.

There is additional evidence that SL officers outperform their peers. Table 6 presents linear regressions where the dependent variable is the quarterly bonus earned by a loan officer. This is a useful metric for two reasons. First, the bonus system has been developed to promote the behavior they expect from loan officers. Accordingly, the bonus represents a significant portion of a loan officer's salary (up to 270 percent of the base salary). It is calculated through a mathematical formula derived directly from a loan officer's monthly performance on delinquency rates, new loans generated, size of outstanding portfolio, and client renewal rates. Second, bonus systems were remarkably similar across the three MFIs, which further validates their legitimacy as a performance metric. The results show that, on average, SL officers tend to earn 23 percent higher bonuses, while LL officers earn 10 percent higher bonuses than their undefined peers.[22] This difference persists even after controlling for the average characteristics of an officer's client pool, and the difference between the SL and LL coefficients is significant.

INSERT TABLE 6 ABOUT HERE

It is puzzling that officers who sidestep the procedures that were designed to simplify their work seem to outperform others. Why, for example, don't they generate the kind of moral hazard that LL officers –and microfinance theorists—worry about?

An initial clarification is that breaking a rule is never an automatic response. Loan officers must exercise their discretion explicitly and emphasize it in their interactions with clients. They highlight the personal risks involved through expressions like "I will take this risk with you … and I may get in trouble with my boss, but…" Thus, when officers emphasize that they are bypassing standard procedures to make an exception,

[22] The dependent variable is the bonus earned as a percentage of the base salary. The distribution of bonuses is close to normal. Regardless, different specifications were tried and the results were robust. Data were collapsed at the loan officer level, creating means for all the relevant variables.

they also remind clients that those policies and their potential enforcement remain in place. Clients know this:

> We missed payments because one of us had some problems (…) I was expecting the lawyer to knock on my door any day (…) (the officer) offered us to restructure our loan and with the lower payments, we put in an effort and managed to pay (…) Even though I really needed it, I didn't dare ask for a renewal, but (officer) visited again and encouraged us to renew our loan. I have never missed a payment again.

Second, and related, clients understand exceptions as one-shot deals. In the restructuring negotiations I observed, loan officers often said "If you fail me on this, I will not be able to help you again." Consecutive restructurings are thus not practiced. Third, and consequently, personal exceptions made by loan officers can generate an additional level of commitment, through reciprocity, from clients who receive them at times of extreme need (e.g. Gouldner):

> (The officer) took the time to learn why we had missed the payments, she restructured our loans, and she helped us explain the problems to the branch manager (…) We offered some of our things as payment but she did not accept them (…) Every time I get extra money I take it straight to the branch (…) I feel very indebted to her, I will not let her down.

This leads to the most profound mechanism: a client's performance is often a function of the officer's behavior (Lipsky 1980; Bearman 2005: p.91, 185). Just as an exception at a time of need can generate a strong commitment, a lack of trust during a crisis may create a self-fulfilling prophecy where the client feels disempowered and disrespected, thus engaging in punitive behaviors or detaching from the relationship (e.g. Peel 1998; Tyler 1998):

> This officer is treating me like a criminal, as if I were missing payments by choice (…) He thinks that by trying to scare me with legal threats I will pay my loan, but I know that they can't do anything to me[23] (…) tell me something: here is my neighbor who lent me money when I got in trouble and here is (officer) who has threatened and insulted me. I am going to pay both debts eventually, but which do you think I will repay first?

The last two quotes come from very similar clients. They are both seamstresses, they both got in trouble because their children had an illness, they had similar loan sizes, and they both had similar credit histories. In the first case, she stayed on as a successful client with

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[23] Mexican legislation does not allow for collateral confiscation to cover individual loans. Loan officers use the threat under the assumption that clients ignore the law. Most clients, however, know their legal rights beyond what MFIs suspect. This, of course, only exacerbates feelings of insult.

a stronger commitment to the officer. In the second, the client was dropped from the program after she was coded as bad credit risk.

Organizational Limits to Rule Divergence

What is an organization to make of this? None of the MFIs in this study have analyzed rule-breaking systematically, but managers in all of them had an intuitive understanding of its performance advantages. Moreover, they often acknowledge that it is only through rule-breaking that they can improve policies (See also Author 2011, Forthcoming). For example, while the three firms have now implemented formal policies for loan restructurings, only one of them was actively experimenting with them at the time of my fieldwork. Formal rules only defined collections through legal action and asset confiscation. A policy was only instituted after SL officers had extensively practiced informal restructurings:

> It all started with (officer) (…) he told me that he had refused to collect from a couple of his clients and had informally restructured their loans instead. His branch manager supported him at first (…) but as the number of restructurings increased, the manager became increasingly nervous and demanded that he seek approval form me. We went over the numbers, and his clients were actually doing very well, so I authorized further restructurings. After that (the branch manager), (the officer), and I met many times to discuss how to create a policy and we refined it by talking to other officers who were doing similar things. (Credit Director, FL)

New products like seasonal loans, fixed asset loans, or business training; or policies for handling collateral or loan increases have all been created through organic experimentation:

> There are always policies that don't match reality, either because we did not get them right the first time or because things are changing (…) For example, there is a policy (to prevent over-indebtedness) that says that clients can only receive a 15% increment on loan payments when renewing a loan. This can be a stupid policy when clients need more (for example) to take advantage of a (supplier's) promotion as it only pushes clients to seek a second loan elsewhere (…) So, the loan officer makes an exception. After a few exceptions are made we change the policy (…) But the officers come up with the exceptions, not us. (Regional manager, FR)

As managers pursue the benefits of rule-breaking, however, they quickly encounter its limits:

> I was a top performer as a loan officer, so I was quickly promoted to branch manager. I like working in trusting environments, but at the beginning I created too trusting an environment at the branch (…) I gave clients and officers too much leeway and way too

> many chances. It was a real learning experience as some of my loan officers who were great kids and had great potential started stepping out of line. I learned the importance of limits and of pushing back. When you don't, the lines become too blurry. (Regional manager, FL)

A zone coordinator further illustrated this:

> There is a branch where we have to fire all the loan officers (…) they have incredible relationships with their clients, but it is amazing, they have come to rely so much on client relationships that they no longer know how to do credit analyses (…) A loan officer the other day flat out told me that the liquidity index was not so important in one case because the loan was actually going to be used by the cosigner, not the client. That is just bad credit risk, bad credit analysis that will catch up with them sooner or later.

And then there are the pressures for standardization that are painfully felt by managers:

> Do you know how many loan officers I have to manage? And how many clients that translates to? I just don't have time for this shit (every loan officer making exceptions). This is not a Montessori school. Unless you have a damn good reason not to, just follow the fucking rule. Don't create unnecessary bullshit (…) But you see the difficulty? I wish they could all just follow the rules (…) but I need them to try new things when the policies don't work well! (Regional manager, FL)

The question, of course, is how to differentiate 'necessary' from 'unnecessary' divergence. All top-level managers recognized the need to strike a balance between rule enforcement and flexibility, but none could articulate how to achieve it beyond listing it as their key challenge. Given that discretion needs to be exercised at the loan officer level, the idea of hiring and training officers who can navigate between the two extremes is initially appealing. These loan officers would comply with the rules most of the time and only challenge them when it is absolutely necessary. They would create embedded relationships with clients, but would draw a boundary before they generated problematic commitments. They would seek to gain valuable information from relationships, but would draw a line before they clouded their judgment. They would, in summary, become "microfinance professionals" who have clear guidelines but also can be trusted to know when and how to exercise discretion. The evidence, however, suggests that this is hard to achieve. After all, loan officers who straddle between the two extremes are worse performers than the 'pure types' on every measure. While it is true that they have not been trained as suggested above, the results do provide a window into why the approach may be difficult.

First, consider that most transactions look similar on paper and through the clients' narratives. To learn enough information to exercise discretion wisely requires depth in the relationship with clients, which is difficult to moderate or simulate. Clients in fact experience the attempt by an officer to establish personal yet guarded relationships as instrumental, which leads them to *lose* trust in the loan officer. Second, consider that for most clients microfinance is the first exposure to financial products. As a result, the relationship with loan officers is as much about the performance of their loan as it is about learning how a credit relationship *should* work (c.f. Baron *et al.* 2001; Bearman 2005). It is thus easier for clients to learn what to expect from a loan officer who sends a consistent signal, which helps explain why unidentified loan officers perform worse than the other two types (see also Author Forthcoming). Moreover, the relational paths are self-reinforcing. Given that client behavior is a function of the loan officer's treatment, officers often confirm their prior assumptions about clients by *generating* the expected behavior through each interaction, thus creating stable paths (e.g. Greif 1993; Hardin 1993).[24] More fundamentally, however, MFIs don't have the time, the resources, or the structure required to support a truly professional workforce.

Loan officers are usually hired through three channels. Some are hired straight out of college, from economics or finance degrees at popular universities or vocational schools. Others are recruited because they or those close to them were once successful clients. The rest are "poached" from competing firms, but this is usually seen as a problematic strategy, as officers come with the "virtues and vices of competitors". Most loan officers thus enter microfinance with no prior experience in a formal organization and armed, at best, with a college degree. MFIs provide training programs, of course, but they are limited by work demands and restricted resources. As a result, most training programs consist of one or two weeks of formal instruction on company policies and the basics of microfinance followed by two to four weeks of on-the-job training through apprenticeship. This is hardly the kind of disciplined, certified training that can generate

[24] During follow-up interviews managers expressed their firm belief that loan officer styles are stable. Once a loan officer finds a style that resonates, they tend to stick to it, mostly because of confirmation bias.

clinical judgment. Rightly so, since MFIs are under extreme pressure to reduce labor costs. Two common metrics used to compare MFIs are loan officer salaries as a percentage of the loan portfolio and the number of clients per loan officer.[25] As a result, loan officer salaries tend to be relatively low, especially in relation to the demands of loan officer work. Not surprisingly, loan officers are low in status, both within the organization and beyond.

Yet, for all the shortcomings of loan officer work, they are expected to make difficult decisions, with very limited resources, on a large number of clients.

> Most loan officers are just kids. For most of them this is their first job. If they get promoted, it will be the first time they are ever in charge of other people. (…) We end up relying too much on people who are just too young; they have no way of knowing enough to solve these complex problems. (HR manager, FL)

Loan officers therefore lack the training, status, or resources available to professionals. Yet, they often have to use their discretion with potentially life-defining consequences for clients. I have documented that they can use discretion in productive ways, but it is also clear that MFIs cannot simply rely on loan officers' judgment, especially at an organizational level. Thus the key puzzle for MFIs, which managers struggle to answer, is how to create conditions that will reliably bound loan officer discretion to productive outcomes, given that loan officers cannot be expected to exercise reliable clinical judgment.

Branch-level Balance between Enforcement and Flexibility

Models IV to VIII in table 5 begin to outline a potential answer. These models analyze how branch-level indicators affect loan performance. The DV is still the probability that a loan will become delinquent. The models show, for example, that when a branch has had a higher incidence of delinquent loans in the past, subsequent loans are more likely to miss payments. More relevant is how the concentration of specific loan officer types at the branch level affects loan performance. It is important to remember that all models include branch and year effects, so all the results presented here refer to within-branch

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[25] See, for example, www.mixmarket.org. The average number of clients per loan officer, for example, is around 250.

changes. Models IV and V show a first couple of puzzling results. Even though SL officers individually outperform their peers, a higher concentration of them within a branch seems to be detrimental to loan performance. Model IV shows that, as expected, there is a positive relationship between the percentage of SL officers within a branch and loan performance, but model V shows that this relationship is highly non-linear. In fact, while adding one SL officer to a branch generally improves loan performance, the effect of SL officers becomes detrimental once more than two are brought in. Models VI and VII show that the opposite holds true for LL officers.[26] Model VIII provides further insight: the coefficient for the interaction between the two types of loan officers is highly negative and significant. This suggests that, when the addition of a LL officer to a branch is matched by adding a SL officer, they *jointly* improve loan performance. When the same models are run with broader levels of loan officer concentration –at the region or zone level, for example—the results completely disappear. Thus, team composition only affects outcomes at the branch level.

Two separate mechanisms account for these results. First, when too many officers make exceptions constantly, then “exceptions become the norm” and they “start making decisions that they just don’t have the authority to make. If this happens, the system starts to break down”. If clients encounter one loan officer who makes an exception, they attribute it to the individual, especially when, for example their relatives have contrasting experiences with other loan officers. In contrast, if clients observe that most loan officers make exceptions, then they are likely to attribute them to the system, which undermines the enforceability of all the rules.

The second, stronger mechanism involves how decisions are processed at each branch. I have documented how SL officers obtain additional client information that leads them to break rules and benefit the organization, but this is naturally a matter of degree. From the officer’s perspective, it is difficult to draw the line between productive and destructive divergence. Put differently, it is hard for an officer to identify when personal ties stop

[26] Models exploring the effects of undefined officers are not reported for brevity. The results show that adding an undefined officer is always detrimental.

providing useful information and start clouding judgment or generating conflicting commitments. Yet, all credit decisions are processed within each branch, through credit committees. There is a standard procedure for running credit committees, presenting cases, and approving loans that, like every other policy, is enacted differently at each branch:

> In some branches, all the loan officers are very analytic, so the committees become like pissing contests, officers just try to prove to each other who knows the policies better (…) This becomes costly because many good loans are rejected. (But) if all the loan officers are only thinking about pleasing clients, then the committees become like love fests, where everything is approved (…) Ideally, you have voices that push everyone to be rigorous in their analyses (…) but you also want voices that put a face on each file. (Regional manager, CG)

When a SL officer brings a proposal to her branch, it is hard for her –or colleagues who operate like her—to gauge when an exception might overstep the boundary of justifiability. Within organizations or broader systems, rule violations require justifications (Walker *et al.* 1988; Zelditch 2001). For SL officers, exceptions made to help good clients always meet a standard of propriety (what seems fair), which makes it hard for them to understand when they fail to meet a standard of validity (what others in the organization think is justifiable). Other officers who are rule oriented can push back and force all exceptions to meet that organizational standard. This forces divergence from rules to be justified according to the *principles behind* existing policies. The opposite is also true. When LL officers miss instances where following a rule may be unproductive, their SL peers can push them to behave more fairly.

It is interesting to note that top managers never articulate this, even though field managers seem to have an intuition for it. During follow up interviews I asked ten zone and regional managers at FL (with years of previous experience as branch mangers) to describe their ideal team. I asked them to name specific loan officers who they would recruit. I then asked them to describe the qualities and contributions of each loan officer:

> I would first get "M", she is very centered, she knows the policies very well and she questions all other loan officers when they present cases. (…) Then, "J" is a true service person. He always thinks of what his clients need, (…) he knows everyone in the community (…) he is the best salesman. "A" is also very connected to her clients, but she is much more confrontational. She rarely agrees with the policies, and always proposes ways to combine them or change them to better serve her clients. Finally, "R" is an

> analytic whiz. He can very quickly find an assumption that is wrong in a credit analysis, or a number that does not seem to make sense (…) he pushes others in his branch to do better credit analyses.

It is telling that every one of these managers designed an ideal branch with similar types of diversity.

Discussion: Localism and Professional Identities in Microfinance

The challenge for an MFI is that, while discretion necessarily occurs at the level of loan officers, they lack the training, the resources, the structures, or the status to exercise clinical judgment reliably. Loan officers are not professionals –far from it—yet they are routinely pushed to make decisions that, both in complexity and potential consequences, demand professional discretion. They are thus stuck with the worst of two worlds. They have the status, salary, and career prospects of a line worker; yet they have the responsibility of a professional. Loan officers are thus semi-professionals, bearing the costs but not the benefits of a profession. The organization requires their discretion, yet it cannot systematically rely on their professional judgment. The puzzle, then, is how to create structures where discretion can be limited productively. In the case of MFIs, a solution seems to lie in the creation of branches where officers with a diversity of enforcement styles must convince each other of the legitimacy of their decisions. Even though managers cannot articulate how it occurs, whenever tensions found within MFI rules are solved, it occurs through regional managers, who observe the positive variation created within certain branches and typify it, elevate it to upper management, and ensure that it becomes habituated through policy changes (Berger, P.L. & Luckmann 1966). To explain this, we must explore the process through which loan officers shape their identities.

To remain useful, organizational rules must retain legitimacy. But legitimacy is a process as much as it is an outcome. For once a rule is established and recognized it immediately becomes problematic, as things inside and outside of it become possible alternatives (Taylor 1993; Stryker 1994; Johnson, C. *et al.* 2006). Often, as is the case in microfinance, behavior only becomes deviant *after* a rule defined it as such, not because

of the behavior itself (Becker 1953; Goffman 1959, 1963; Matza 1969; Spitzer 1975; Becker 1991). Rules thus become resources that actors use to shape organizations in purposeful ways (Stryker 1994; Feldman & Pentland 2003). But an actor's ability to do this depends on whether her actions are recognized as legitimate by other organizational actors; or whether violations are justified not only in terms of propriety (fairness) but also in terms of validity (Walker *et al.* 1988; Zelditch 2001; Johnson, C. *et al.* 2006). It hinges on the different orientations on legitimacy held by actors across an organization, which are shaped entirely by their professional identities (Stryker 1994).

Loan officers may not be professionals, but they certainly have professional identities and aspirations. The problem, however, is that without the underpinnings of a profession these identities and aspirations can vary widely. Most loan officers had never worked in a formal organization, let alone a financial firm. While MFIs provide them with centralized guidelines and training, loan officers spend the vast majority of their time on the field, interacting with clients. Just as clients are only connected to an MFI through loan officers, the latter are only connected to the organization through the colleagues at their branch. For most loan officers, the MFI is a loose concept that they only interact with once a quarter. As a result, the definition of what it means to be a loan officer or the creation of their professional identity occurs through the daily interactions with other officers and the manager of their branch. It is at this level that loan officers define how they want to –how they *should*—relate to the MFI. Their isolation from the central organization, coupled with the complexity and uncertainty of their work creates a high level of "localism", where who they are *as loan officers* is determined not by the MFI, but by the people that surround them (Bearman 1991). Moreover, their relatively low status within and beyond the organization further drives loan officers to develop a professional identity, to seek claims to professionalism as a defense of their work and standing (Author 2011). But the definition of what it means to act professionally in microfinance varies across individuals and branches.

Managers know this, to some extent, as they frequently describe branches as having "distinct personalities" that shape loan officers "permanently". They talk about different

branches as “competitive”, “well-behaved”, “renegades”, “lost souls”, or “geeks”. They believe branch managers can have some effect in shaping local identities, but they also describe how, once a branch acquires a “personality”, it is very hard to change it without rotating most of the loan officers. Branch managers who try to confront local identities can be “burned” or “neutralized” rapidly. It is also interesting, however, that managers don’t make the connection between these local branch identities and the extent, type, and productivity of loan officer discretion. For top managers, the narrative is that tensions inherent in policies are resolved by designing better policies. They recognize that loan officer experimentation informs policies in important ways, but, ironically, they believe loan officer discretion can only be channeled through stricter policies, and they have no consistent solution for how to differentiate –ex ante—between productive and unproductive rule breaking.

It is in this context that the importance of diversity at the branch level can be understood. I previously established that, while loan officers reveal a diversity of behavior, the diversity emerges from the similarity –and not the diversity—of their commitment to their work. Loan officers share a moral commitment to their role, but how this commitment is understood varies. If a branch contains only SL officers, then their professional identities will be shaped solely around client needs and their connection with organizational policies and goals –like profitability and enforceability—will be increasingly tenuous. When only LL officers interact, their connection with *clients* –the ultimate purpose of the MFI—is increasingly dissolved, as they begin to relate to policies in legalistic terms. For SL officers, then, a diverse environment develops an identity as part of a broader organization, as they are constantly forced to consider not only the propriety, but also the validity of their proposed exceptions *in the eyes of the MFI*. It is the branch environment that determines whether an SL officer will become a renegade or a “sociological citizen” with the capacity to “view the organization as a dynamic entity” and use this extended understanding to fashion organizationally beneficial solutions to local problems (Silbey *et al.* 2009; Author 2011). For LL officers, a diverse environment is a constant reminder that clients are an additional and important institution that should

compete within the organization, in equal terms, with other institutions like organizational policies (Heimer 1999).

The reality of localism is probably inescapable for MFIs. It is conceivable that MFIs could develop stronger ties to their staff through more frequent firm-wide gatherings and other socialization processes. That said, the nature of microfinance, the economic realities faced by MFIs, the geographic dispersion of their activities, and the diversity of their client population severely complicates things. That said, MFIs certainly can create local environments that consider localist dynamics and foster stronger identification with the organization through (supervised) diversity that demands consensual decisions. To some extent, as I documented in this paper, this occurs naturally through the random distribution of loan officers in branches. As a result, some branches accidentally become laboratories for better policies. Regional managers observe them and learn from them. However, since managers do not recognize the dynamics of localist identities, the same randomness that produces laboratories also produces "renegade" and "geek" branches, which are costly to the organization.

More importantly, since better policies –and not better professional identities—are often seen as the only possible rein on loan officer discretion, two unintended consequences occur. The first is that, ironically, with each additional effort to standardize and automate loan officer work, the pressure for loan officers to exercise discretion increases, both because automation is coupled with reduction in resources and increases in workloads and because new policies bring in additional complexity. The second is that, in the effort to standardize work, MFIs can throw the baby out with the bath water. One of the MFIs in the study, for example, has since sought to streamline and standardize credit decisions by using credit scores more prominently, eliminating branch-level committee meetings, and merging small branches into larger "hubs" that require less loan officer presence – making their day easier through reducing administrative burdens. Lending has indeed become more efficient and loan officers indeed spend more time on the field. These short-term benefits, however, have been overshadowed by a very gradual deterioration of

some loan portfolios. Worse, the firm has, for the first time in its history, encountered widespread corruption.

> There have always been people who break the rules, there have always been people who make mistakes, there have always been people who, in not following a policy end up screwing up, but it was always limited and it was almost always with good intentions (…) We had never had situations where so many loan officers engaged in outright stealing, cheating, and lying. (…) We don't understand it, nothing has changed in our recruiting or training processes, we are deeply concerned. (Director, FL)

Conclusion

Microfinance Institutions experience, with particular intensity, the tension inherent in all organizational rules. There is a real need to develop policies that standardize, streamline, and increase the efficiency of MFI processes. Both because external constituents expect it and because internal economic realities require it, MFIs must create—and enforce—rules. At the same time, the nature of microfinance is such that loan officer discretion in the enactment of rules is not only unavoidable but also desirable.

Loan officers, therefore, are often required to use discretion in the enactment of policies and make decisions that are truly consequential for their clients' wellbeing. Yet, while these decisions mirror the responsibility and complexity faced by professionals, loan officers lack professional underpinnings –training, resources, status. They are semi-professionals who bear enormous responsibility and often exercise discretion but have the standing, salary, and workload of line workers. As a result, MFIs cannot rely systematically on loan officers' judgment, since there is no professional standard to guide it. Furthermore, the organization has little ability to determine, ex-ante, which specific divergences from policy will be productive. In fact, this paper showed how, even though loan officers who tend to break the rules individually outperform their peers, when the proportion of rule breaking loan officers increases within a branch, their behavior becomes detrimental. It also suggests that it is the loan officers' identity in relationship to the MFI that determines whether deviance can be expected to be productive.

The paper argues that, even though they are not professionals, loan officers have a professional identity and certainly seek to claim professionalism in their actions (see Bearman 2005). The study confirms that loan officers define what they deem as

legitimate enactment –either application of or deviance from—rules through the lens of that professional identity (Stryker 1994). The issue, however, is that the absence of all the elements of a true profession, coupled with the nature of microfinance results in loan officer identities that are initially fickle and are defined through daily interactions with peers and clients that occur at the branch level. As a result, loan officers who encounter peers with similar backgrounds and enforcement styles can develop highly localist identities that are decoupled from the broader organization (Bearman 1991). In contrast, loan officers who encounter diversity in their branch are consistently pushed by peers to justify decisions–and what it means to be a loan officer—through the lens of *organizational* validity (Walker *et al.* 1988; Zelditch 2001). These processes of justification awaken a broader identity that allows the officer to view her actions as a part of a broader system that she is intimately related to (Bearman 1991; Silbey *et al.* 2009).

On many dimensions, microfinance is a unique phenomenon. Its characteristics, client populations, and dynamics are unlike any other setting. Yet, there is much about the structure of MFIs and the nature of loan officer work that we recognize elsewhere. At the most immediate level, MFIs are simply street-level bureaucracies, with similar pressures and dynamics (Lipsky 1980; Author 2011). We can thus expect many of the tensions described here to arise for other street-level bureaucrats like teachers, labor inspectors, prosecutors, or social workers (Wilson 1989; Coslovsky 2011; Piore 2011; Silbey 2011). More broadly, advances in technology have transformed how decisions are made –and the extent to which they have been automated—in all kinds of organizations, from finance to the medical profession. Recent events in finance, for example, reveal how the automation and atomization of credit decisions have increasingly separated firms from their markets and, most importantly, those who make credit decisions from those who absorb the risk of those decisions (see Zuckerman, G. 2009; Bhide 2010; Johnson, S. & Kwak 2010; Zuckerman, E.W. Forthcoming).

This paper suggests that, while a common response to organizational tensions between rules and their enactment is to create more, better, and stricter policies, the first-order benefits of this strategy may be quickly overcome by its second-order consequences. It

also suggests that, for many organizations, a more sensible approach may be to recognize the inevitability –and desirability—of employee discretion; the relationship between an employee's professional identity and her understanding of legitimate uses of discretion; and the types of environments that foster broader, as opposed to localist, professional identities.

Tables

Table 1 – Lending Methodology and Geographic Focus by Company

	Lending Methodology			Geographic Focus	
	Communal Banks	Solidary Groups	Individual Loans	Urban	Rural
FL	No	Yes	Yes	Yes	No
FR	Yes	No	No	Yes (some)	Yes
CG	Yes	Yes	No	Yes	Yes

Table 2 – Main Variables and Descriptive Statistics

Variable	Description	Mean	Median	SD	Min	Max
Bonus	Percentage of salary received as bonus, end of year total (x 100)	1.11	1.11	0.51	0	2.766
Branch % Letter	Percentage of LL officers in the branch that originated a loan	0.2	0.125	0.24	0	1
Branch % Spirit	Percentage of SL officers in the branch that originated a loan	0.344	0.333	0.31	0	1
Female	Dummy Variable. Takes the value of 1 for women	0.624	-	0.484	0	1
Firm	Dummy Variable. Takes the value of 1 for incorporated firms (0 for individual lenders with unregistered businesses)	0.002	-	0.016	0	1
Frequency	Days between scheduled payments	15.5	14	14.42	7	86
Group	Dummy Variable. Takes the value of 1 for group loans	0.15	-	0.357	0	1
Previous Delinquency	Total number of previous loans where the client has missed a payment	0.617	-	0.989	0	10
Interest Rate [1]	Yearly interest rate charged	80.122	77	6.476	58	96
Latepmt	Dummy Variable. Takes the value of 1 if there has been a missed payment in the life of the loan	0.275	-	0.446	0	1
Loan Amount [1]	Size of the original loan, in thousand pesos	9.359	6	10.43	0.3	500
Payment [1]	Size of scheduled payments, in thousand pesos	1.114	0.544	1.924	0.02	20
Pct. Change in Amount [1]	Percentage increase of amount from one loan to the next	0.9	-	3.03	-0.99	11.9
Restructuring	Dummy Variable. Takes the value of 1 if the loan has been restructured	0.006	-	0.074	0	1
Twomissed	Dummy Variable. Takes the value of 1 if a *second* loan is missed *conditional* on a first missed payment	0.479	-	0.499	0	1

[1] The log of these variables is used in the analyses.

Table 3–Some Key Metrics by Branch[§]

Branch	Delinquency Rate (amount)[1]	Delinquency Rate (loans)[2]	Growth[3]	Median Increase in HH Income	Mean Monthly HH Income	Median HH Income
11	10.35 %**	22.4 %**	6.2 %	1.6 %**	2,315	1,720
21	7.14 %*	17.9 %**	6.0 %**	8.0 %*	2,496	1,804
22	4.05 %**	10.4 %**	11.2 %**	21.8 %	2,542	1,827
24	3.48 %**	10.1 %**	9.2 %*	25.8 %**	2,200	1,704
25	10.00 %**	19.1 %**	0.8 %**	22.0 %	2,362	1,641
26	7.90 %*	7.9 %**	8.0 %	24.0 %*	2,050	1,530
31	7.82 %	17.8 %**	3.3 %**	23.0 %*	2,583	2,156
32	5.16 %**	5.2 %**	14.4 %**	5.0 %	2,089	1,597
41	5.52 %**	11.7 %**	4.6 %**	14.0 %	2,070	1,590
42	5.93 %**	15.0 %**	11.7 %**	16.0 %	2,145	1,678
43	8.14 %**	17.4 %*	-0.9 %**	6.0 %**	2,268	1,833
51	8.68 %**	20.7 %**	10.7 %*	2.0 %*	2,314	1,724
52	8.57 %**	19.7 %**	-7.1 %**	55.0 %**	2,287	1,844
Overall[4]	7.51 %	16.3 %	7.82 %	17.0 %	2,342	1,768
SD	2.11 %	3.8 %	6.72 %	38.2 %	1,799	1,799

Correlations	Mean Income & Delinquency	STD Income & Delinquency	Median Income & Delinquency	Mean Income & Growth
	0.19	0.3	0.26	-0.24

[§] Only a selection of branches shown –representative sample of branches, based on geography (branch numbers are assigned according to regions: 21, 22, 24, 25, and 26 are in the same geographic region, for example).

** Difference between branch average and FL average significant at 0.01 * Significant at 0.05.

[1] Measured as % of total amount lent by branch –These figures may seem high compared to international standards. It is noteworthy that they refer to two-week delinquencies, vs. the standard view of one month.

[2] Measured as % of loans.

[3] Measured as average monthly increase in total amount lent by branch.

[4] All FL branches not just the sample.

Table 4 – A Typology of Loan Officers

Rule	"Spirit of the law"	"Letter of the law"
- Loan officers should maintain an institutional relationship with clients. Clients should see the LO as the institution, not as the person	- Relationships with clients at a personal level - Emphasizes personal character of relationship with client while constantly referring back to company as "the boss" or "company policies"	- Relationships with client at an institutional level - Emphasizes professional character of relationship, constantly highlighting the fact that he/she only represents the company and its investors
- LO should know the status of the client's business in terms of its profitability	- Close follow-up of business as well as personal activities, family issues, friendships, etc.	- Interaction mostly on a transactional basis, limits interaction to credit-related issues and business liquidity
- LO should know whether a client's referrals and guarantors exist and are trustworthy	- Knows a client's business and personal network and often refers clients to other clients, building wider networks	- Does not like to "get involved" with clients, prefers to maintain arms-length relationship and only checks on client's network to ensure potential pressure for repayment
- LO should not give business advice to clients due to liability issues	- Open to provide advice on business issues	- Afraid to provide advice on business issue with a "we could be liable" argument
- If a client is in trouble, negotiated agreements can be reached, but it is the LO's discretion	- Engages in joint problem-solving with client, especially in times of trouble	- No joint problem-solving, only interacts on contractual terms
- Loans must be collected upon and it is one of the most important measurement metrics	- Emphasizes trustworthiness of clients –"most clients want to pay"	- Emphasizes that clients can be devious –"most clients want to shirk"

Table 5 – Logistic Regressions on the Probability that a Client Will Miss a Payment

Model D.V.	I latepmt	II twomised	III latepmt	IV latepmt	V latepmt	VI latepmt	VII latepmt	VIII latepmt
Frequency	-0.0291*** [0.000708]	-0.0131*** [0.00103]	-0.0291*** [0.000708]	-0.0268*** [0.000657]	-0.0267*** [0.000655]	-0.0271*** [0.000658]	-0.0270*** [0.000656]	-0.0268*** [0.000656]
Loan Amount	1.048*** [0.00798]	0.133*** [0.0149]	1.048*** [0.00798]	0.880*** [0.00833]	0.881*** [0.00834]	0.881*** [0.00834]	0.881*** [0.00834]	0.880*** [0.00833]
Payment Amount	-1.124*** [0.00995]	-0.118*** [0.0168]	-1.124*** [0.00995]	-0.946*** [0.0102]	-0.948*** [0.0102]	-0.948*** [0.0102]	-0.948*** [0.0102]	-0.947*** [0.0102]
Interest Rate	5.211*** [0.0504]	5.333*** [0.0803]	5.211*** [0.0504]	5.619*** [0.0520]	5.609*** [0.0520]	5.641*** [0.0520]	5.624*** [0.0520]	5.625*** [0.0520]
Female	-0.0547*** [0.00727]	-0.102*** [0.0115]	-0.0548*** [0.00727]	-0.0472*** [0.00737]	-0.0469*** [0.00737]	-0.0477*** [0.00737]	-0.0474*** [0.00737]	-0.0472*** [0.00737]
Group	0.0738*** [0.00983]	0.154*** [0.0148]	0.0738*** [0.00983]	0.0481*** [0.0100]	0.0464*** [0.0100]	0.0522*** [0.0100]	0.0513*** [0.0100]	0.0487*** [0.0100]
Firm	0.775*** [0.263]	0.929*** [0.310]	0.776*** [0.263]	0.947*** [0.288]	0.940*** [0.287]	0.947*** [0.287]	0.952*** [0.287]	0.942*** [0.288]
Previous Delinquency	0.212*** [0.00252]	0.0951*** [0.00397]	0.212*** [0.00252]	0.213*** [0.00254]	0.213*** [0.00254]	0.214*** [0.00253]	0.214*** [0.00253]	0.213*** [0.00254]
Spirit	**-0.125*** [0.00840]**	**-0.512*** [0.0135]**	-0.124*** [0.00841]	-0.0678*** [0.00868]	-0.0681*** [0.00869]	-0.115*** [0.00853]	-0.119*** [0.00854]	-0.0686*** [0.00873]
Letter	**-0.131*** [0.00986]**	**-0.420*** [0.0158]**	-0.131*** [0.00988]	-0.127*** [0.00994]	-0.132*** [0.00996]	-0.148*** [0.0101]	-0.150*** [0.0101]	-0.132*** [0.0101]
Restructured	1.063*** [0.0517]	1.620*** [0.0628]	1.132*** [0.0710]	1.013*** [0.0509]	1.012*** [0.0509]	1.024*** [0.0509]	1.024*** [0.0509]	1.013*** [0.0509]
Restructured * Spirit			**-0.268** [0.123]**					

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Restructured * Letter			**-0.0151** **[0.134]**					
Lagged Branch Delinquency				0.0162*** [0.000319]	0.0160*** [0.000319]	0.0172*** [0.000317]	0.0168*** [0.000320]	0.0163*** [0.000320]
Branch % Spirit				**-0.727*** [0.0262]**	**-2.222*** [0.0946]**			**-0.597*** [0.0369]**
Branch % Letter						**0.402*** [0.0279]**	**1.491*** [0.0903]**	**0.227*** [0.0422]**
% Spirit Squared					**1.929*** [0.118]**			
% Letter Squared							**-1.596*** [0.127]**	
% Spirit * % Letter								**-0.455*** [0.118]**
Intercept	-28.66*** [0.564]	-25.76*** [1.160]	-28.66*** [0.564]	-27.94*** [0.328]	-27.58*** [0.329]	-28.24*** [0.330]	-28.52*** [0.330]	-28.07*** [0.330]
Observations	438,252	142,623	438,252	438,252	438,252	438,252	438,252	438,252

Robust standard errors in brackets -- Errors clustered at the client level. Clustering at the branch level generated the same results.

All models include branch and year effects.

*** p<0.01.
** p<0.05.
* p<0.1.

Table 6 – Linear Regressions on Earned Bonus

Model	I	II
D.V.	Bonus	Bonus
Spirit	0.231***	0.230***
	[0.0458]	[0.0454]
Letter	0.102*	0.111**
	[0.0541]	[0.0545]
Change		-0.101
		[0.0697]
Frequency		0.0129
		[0.0144]
Loan Amount		0.490*
		[0.253]
Payment Amount		-0.553**
		[0.245]
Interest Rate		2.805**
		[1.362]
Female		0.261
		[0.275]
Group		0.0397
		[0.199]
Firm		3.73
		[7.703]
Delinquency		0.0103
		[0.112]
Restructured		-1.544
		[3.841]
History of Late Payment		-0.572**
		[0.255]
% Change in Amount		0.303***
		[0.0935]
Intercept	-0.680***	-14.49**
	[0.0812]	[5.893]
Observations	827	815
R-squared	0.34	0.36

Robust standard errors in brackets -- Errors clustered at the loan officer level. Clustering at the branch level generated similar results.

All models include branch and year effects.

*** p<0.01.

** p<0.05.

* p<0.1.

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