Research and Policy Briefs

mfi-Crisis
Microfinance in Crisis

Number 8, 2013

Loan officers and preventing overindebtedness – the case of Banco ADOPEM

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The prevention of overindebtedness is a topic which practitioners and academics are currently addressing in the aftermath of a wave of delinquency crises in some of the most developed microfinance markets in various parts of the world. This note draws on a case study of one of the leading microfinance institutions (MFIs) in the Dominican Republic (Banco ADOPEM) in order to examine the role of credit officers in preventing client overindebtedness.[1]

This work was conducted between May and August 2013 and highlighted two challenging conflicts as regards the research question and which the Bank's board is facing: between organizational structure and loan officers' individuality on the one hand, and between the standardization of procedures and flexibility on the other. At the end of June 2013, structure and standardization were the more influential in terms of repayment performance and the institution's effort to mitigate the risk of overindebtedness.[2]

Overindebtedness and credit officers

While the literature provides different definitions of overindebtedness, and most authors agree that client overindebtedness does not equate to him or her defaulting on their microcredit loan or vice versa, overindebtedness and delinquency are related to one another. This is the case either when the client is unable to repay (inability to repay) or is unwilling to repay irrespective of the capacity to do so (strategic default) (Morvant-Roux *et al.* 2013). Delinquency situations can be seen as signs of overindebtedness, such that it is important to monitor loan portfolio quality in order to prevent overindebtedness (Schicks, 2012; Gonzalez, 2008).[3]

[1] This work was undertaken as part of the Microfinance in Crisis project and as part of the internship of the European Microfinance Programme, which is an Advanced Masters Programme at the Solvay Brussels School of Economics and Management (Université Libre de Bruxelles), the University of Mons and Paris Dauphine University.

[2] The terms 'loan officer' and 'credit officer' are used interchangeably in this paper.

[3] Strategic default refers to situations where clients are unwilling to repay their loans, irrespective of their capacity to do so, and such that they are predisposed from the outset not

Clients become overindebted for many reasons which come under three main categories: borrower, institutional and external factors (Morvant-Roux, *et al*., 2012; Schicks, 2013; Gonzalez, 2008). In this note we will pay particular attention to institutional factors, because credit officers are often the institution's sole point of contact with its clients, and a high proportion MFI staff is credit officers. This is moreover the case of Banco ADOPEM, which on 30/06/2013 had 51 branches across the country and employed 935 people, 47.5% of whom were loan officers.

In terms of the main institutional causes of overindebtedness – focusing on portfolio growth, inadequate products or product combinations, and inadequate lending procedures, namely deficient screening and aggressive recovery policies – credit officers' influence largely comes to bear on credit screening and debt recovery. Several studies have considered the role of loan officers on selection and enforcement procedures and have concluded that their actions can influence credit and repayment decisions, with consequences for the MFIs' performances (Sagamba *et al*., 2013; Agier and Szafarz, 2011; Canales, 2011).

From theory to practice

With such considerations in mind, the primary goal of this fieldwork and statistical analysis conducted at Banco ADOPEM was to examine the institution's structure, policies and procedures, in particular as regards its screening and recovery phases. The findings were then to be used to evaluate whether loan officers' profiles have an influence on the institution's repayment performance, and in particular whether they have a significant role in preventing overindebtedness.

The fieldwork was designed using a combination of qualitative and quantitative methodologies: observation and informal talks with staff from different departments at the institution's headquarters and its branches in the Santo Domingo area, participation at five training sessions for credit officers; and desk work, revising some of the main documents related to the credit process. The second step was going to the field with credit officers to observe both their work and the whole operation of a branch, while also visiting potential, new and existing clients. Information was also requested from the institution's database, mainly about the business and human resources departments.

It was possible to accompany 11 credit officers from different credit programmes and regions in their daily work. The experience showed that both the credit officers and other branch staff are well integrated into their institution's culture and that they do try to follow their management's policies and procedures. Nevertheless, given their different personalities and the fact that they deal with human beings, some flexibility in the application of the rules is anticipated in order to regularly achieve results in a complex and constantly evolving context.

Banco de Ahorro y Crédito ADOPEM: the context

Banco ADOPEM is a regulated financial institution, one of the leading MFIs in the Dominican Republic and was awarded as the

to meet their obligations. This can include cases where clients are able to pay but choose not to, and others where clients know they cannot afford to repay the loan but decide to over-indebt themselves in order to access extra cash.

Best Microfinance Institution in Latin America and the Caribbean in 2012.

Table 1 – ADOPEM Main Indicators

		31/12/2011	31/12/2012	Var.
Total Assets	RD$	3,284,046,398	4,078,245,972	24.2%
Gross Loan Portfolio (GLP)	RD$	2,540,874,030	2,926,338,194	15.2%
Total Deposits	RD$	883,857,684	1,472,588,410	66.6%
Operational Cash flow	RD$	229,201,135	202,555,741	-11.6%
ROE	%	24.4%	25.4%	1 p.p.
Borrowers	N.º	145,995	159,718	9.4%
Depositors Accounts	N.º	198,496	218,182	9.9%
PAR_{30}	%	3.99%	4.09%	0.1 p.p.

Source: Own construction from ADOPEM (2012)

It is a financially solid institution which over the years has implemented policies and procedures regarding the credit process applying the knowledge it has acquired through its own experience and in terms of international best practices in the sector. This process of learning by doing has led to important changes in some of its policies and procedures. One example is stopping allowing people from the same household to join a group in order to obtain loans at the same time, as experience has shown that the loans requested by different members of the family were often used by one of them in a single business, or that the money was being used for other things, increasing the household's overindebtedness risk.

The Dominican Republic is not considered as a saturated market (Javoy and Rozas, 2013), but competition is growing, the country's economic growth is slowing and, at the same time, Dominicans consumerist aspirations are continuing to grow. This and the gradual increase of ADOPEM's default indicators (PAR_{30} grew from 2.8% in 2008 to 4.09% in 2012) justifies bank managers' concern for repayment behaviors, and the setting up of credit policies and procedures prioritizing loan portfolio quality, regardless of it appearing that there is not currently an overindebtedness problem at Banco ADOPEM.

At the end of the first semester of 2013, ADOPEM had 403 credit officers with assigned portfolios. They were managing a total loan portfolio of RD$3,171,064,429, with the microenterprise programme being the core of the institution's activity (in terms of loan numbers and amounts, and the number of credit officers); group loans had a significant outreach in terms of the number of clients, while the small business programme was more representative of the portfolio amount (Table 2).[4]

[4] Banco ADOPEM's credit offer includes five productive credit programmes: groups, microenterprise, rural, small enterprise and Pyme (small and medium enterprises). Given the specificities of the Pyme programme the fieldwork with loan officers and the statistical analysis did not include this programme.

Table 2 – Loan Officers and Portfolio, 30/06/2013

Credit Programme	N.º Credit Officers	Loans (N.º)	Average N.º Loans per Credit Officer	Average Loan Size (RD$)	Average Loan Size (USD)
Group	60	42,010	700	RD$7,393,04	$180
Micro Enterprise	245	98,852	403	RD$17,416,22	$425
Rural	39	13,163	338	RD$18,102,45	$442
Small Enterprise	56	15,052	269	RD$58,341,34	$1,423
Pyme	3	56	19	RD$400,323,84	$9,764
Total	**403**	**169,133**	**420**	**RD$18,748,94**	**$457**

Source: ADOPEM Database

Developing a strong company culture through human resources policies

ADOPEM has a distinctive company culture based on teamwork, ethics and a strong adherence by staff to the institution's main goals (loan portfolio quality and growth). Human resources policies are vital in the development and fortification of this culture through several mechanisms which are thought to give credit officers responsibility for each credit contract in their portfolio, but also show that they are not alone in their efforts and that good results will be rewarded.

These mechanisms include:

- Recruitment strategy: hiring loan officers without previous experience in financial institutions and favoring a specific profile:

Male: 87%
Single: 83%
Universitary Graduate:79%
< 30 years: 67%

- Training programme: none of the officers have previous experience in the sector, so formal training and learning by doing methodologies allow the institution to mold its credit officers to fit a specific profile, giving them the basic skills to work independently.
- Institutionalized career: providing for a continuous growth in loan officers' statuses and remuneration packages, alongside further benefits such as bonuses, paid vacations, life insurance and paying of some of the cost of university to increase staff motivation.
- Monetary incentives package: based on meeting monthly and trimester targets in portfolio growth and quality. Their effectiveness depends on their regularity and how for most officers the targets appear ambitious but achievable.
- Non-monetary incentives such as three annual "parties" where the best employees and branches are awarded. These initiatives allow staff from different regions to get to know one another in an informal setting.
- Negative incentives, including the possibility of dismissal for disrespecting policies and procedures or the inability to reach targets regularly, this being not only a hypothetical threat but an observed sanction.

While credit officers have a common profile in terms of their personal characteristics, accompanying the various loan officers in the field highlighted personality differences which effected their motivations. Although they all valued chances to learn and progress within the institution, some were very keen to build a career in the Bank and to reach top management positions, while others did not exclude working in other institutions or starting their own businesses. Their distinctive personal characteristics also influenced the relations they established with clients. Some of the officers were more extrovert and assertive than others, which translated into different strategies being used to promote the products, collect information or recover payments.

The standardization of procedures

The most recently introduced changes in the Bank's main policies aimed to standardize procedures, gain efficiency and increase control over the staff. The most emblematic measure was the introduction of the typical day (Box 1), which defines the tasks and timing of each moment in the loan officer's day, along with daily targets to be met and documented in the information system. Moreover, branch managers' controlling roles were strengthened and a number of monitoring tools were introduced, increasing pressure on loan officers to comply with the policies and procedures of the management.

Observation in the field made clear that while there is a clear schedule for throughout the day, no one actually managed to fully respect what is set out every day, and in this context branch managers take on a central role in establishing boundaries for the actions of loan officers.

Putting screening and recovery at the center of the credit process

ADOPEM has developed a well designed credit process with screening and recovery at its center, giving loan officers a crucial role but also involving other staff and areas of the institution in a combined effort to meet the institution's objectives. This is supplemented by a strong logistical and technological infrastructure which uses advanced communications equipment to give loan officers constantly updated information at every stage of the credit process.

Screening procedures are fundamental in the Bank's overindebtedness prevention strategies (Box 2). As equally important are the recovery procedures and the development of close client relationships (Box 3).

In terms of procedures, the time spent on tasks varies according to the type of credit products which loan officers managed, and portfolio quality. Time spent on initial evaluations increases from 15 to 20 minutes for group officers to 45 to 50 minutes for microenterprise officers, and even more for rural and small business officers.

Those officers with clients in more distant areas from the branches, usually more vulnerable and poorer, spent much more time on recovery tasks than the others, and had more problems complying with the "rigid" timings of the typical day. Finally, some of the loan officers experiencing greater pressure to meet monthly targets seemed to be encouraged to over-prioritize the pursuit of new loan proposals while neglecting their quality, and to use less reasonable arguments and practices in default situations.

Box 1 – Credit Officers Typical Day

Schedule	Tasks	Location
8:00 – 10:00	Preparation of loan documentation; Credit Committee and Performance Indicators Analysis; Phone Calls to Renewal and Ex-Clients	Branch
10:00 – 10:15	Phone Calls To Clients with Installments to pay this day (especially those at 1st, 2nd and 3rd installment)	Branch
10:15 – 13:15	Field Work: recovery, evaluation, promotion and prospection	Field Work
13:15 – 14:15	Lunch	
14:15 – 16:45	Field Work: recovery, evaluation, promotion and prospection	Field Work
16:45 -	Phone calls to Clients with Installments due on this day and to potential clients identified in prospection. Preparation of daily route for next day.	Branch

Source: Adaptation from ADOPEM internal document

Box 2 – Avoiding overindebtedness through screening procedures

Screening is taken as the crucial moment in the credit process and this is strongly emphasized in ADOPEM training sessions. The initial evaluation of clients starts with an analysis of their indebtedness level, combining formal (an efficient private credit bureau) and informal information sources (clients, family, neighbors and business partners). During the screening process, the client is asked for 3 to 6 references. This does not mean that the officer obtains full information on the client, but there is an effort to conduct a rigorous assessment on this level.

The second step is the evaluation of the client, their household situation and business, with the purpose of supporting the two main decision criteria: repayment capacity and willingness to repay. The first is a quantitative measure which uses both household and business information because, especially for the smallest loans (group), the size and instability of businesses means credit approval cannot be solely based on forecast business returns.

Assessing willingness to repay calls for a qualitative evaluation of the client's intention to keep repaying the loan. While this is more subjective, loan officers use some general indicators:

- ⇨ The client maintains a record of timely repayment to ADOPEM or other financial institutions, and to suppliers;
- ⇨ The client is not applying for loans from different banks at the same time and does not have more than 3 active operations in the credit bureau;
- ⇨ The client has consulted other members of the household before deciding to take the loan and puts a limit on payment installments to remain comfortable paying;
- ⇨ The client has a good reputation in the neighborhood where he/she lives.

By adopting these dual decision criteria, the institution shows from the outset its concern for the inability to repay and of strategic default problems, looking to avoid both through screening procedures.

It is also important to highlight the importance given to the cross-validation of information obtained from the client using several methodologies: direct observations in the home and business of clients and guarantors; gathering documentation for declared incomes (for example, rental contracts or receipts if the client has property rented; bank receipts confirming the regular in-flow of remittances; sales registers, if existing); and contact with the guarantor, family, neighbors and business partners (suppliers or clients).

Box 3 – Recovery procedures and the role of proximity to clients

The fundamental idea behind recovery is that maintaining timely repayment installments has advantages for both parties. Loan officers' main argument to incentivize punctual loan repayment is to say that it will allow the client to build a positive credit history with the institution and the credit bureau and thus to access future loans with improved conditions.

The institution's discourse on recovery is that a friendly attitude towards the client should be maintained even in the event of default, the objective being to retain the client and assure the collection of the money. This is supplemented by putting permanent pressure on the client to repay by developing proximity relations with clients involving branch managers and other staff, as well as the central recovery department in more problematic cases.

Building proximity relations with clients is crucial for retaining clients, encouraging them to acquire other products and to maintain timely repayments. Given the short time loan officers have for each visit, this proximity is accomplished through other strategies. These include regular visits, particularly if the loan officers directly receive the installment payment; geographical proximity between clients, in particular with group loans which allows officers to constantly "run into" clients even when not visiting them; and contact with family and friends who are often also clients. Moreover, clients are often invited to various activities organized by ADOPEM, which helps clients to feel connected to the institution.

Loan officers and repayment performance

The differences observed between the credit officers we accompanied do not seem relevant to the repayment performance of the institution when the whole group of 403 ADOPEM's credit officers is taken into account. There is a low variability in their results as regards portfolio quality, although one finds some extreme cases when evaluating an indicator such as PAR_{30} (Portfolio at Risk over 30 days). This low variability in credit officers' profiles and performances, as well as the standardization of procedures, helps explain the results of the econometrical study we developed. The objective of this study was to test whether loan officers' personal characteristics influenced their portfolio quality performance, using PAR_{30} as the dependent variable in the model. A linear regression model was estimated using the OLS method, including as explanatory variables the personal and professional characteristics of the loan officers, information on the stability of the loan portfolios, the branches and branch managers, and two environmental variables, namely local levels of poverty and competition.

Even taking into account that this was a preliminary analysis, the results show that all the variables relative to personal characteristics were not significant. Instead, the variables with statistical significance were those related to external factors (poverty level and clients' multiple borrowing indicators) or variables greatly influenced by the institution's policies (the regular accomplishment of goals, number of loans, and the experience of the branch manager). The results confirmed the expected relations between explanatory and dependent variables.

The main lessons from ADOPEM

The experience of ADOPEM in the Dominican context appears to be highly influenced by top management strategic decisions and the institution's distinctive culture, but it is important to note that the statistical and econometrical study had a time reference, so only further analysis for other time periods and other institutions can determine how specific this case is. Given the long histories of other Dominican MFIs such as ADEMI and FONDESA, which have their own identities and culture, it would be interesting to develop an analysis of this kind within these institutions, because it could lead to different conclusions on the role of the loan officers.

In the case of ADOPEM there is no overindebtedness problem, and the repayment performance demonstrated in the first semester of 2013 seems to show that the institution is achieving an adequate balance between the standardization of procedures, which is key for attaining gains in efficiency and the sustainability of the institution, and the flexibility also inherent to this type of activity. Nevertheless, is worth noting that the main standardization policies, i.e. the typical day, have been gradually implemented over the last twelve months, such that it is still soon to properly evaluate the consequences of this strategy. It will be particularly significant to analyze changes in staff turnover, and the behavior of the more creative and independent loan officers, who may adapt to the new rules but feel less motivated in their jobs, and less open to contributing their expertise to the learning by doing process that has been so important for the institution.

It is still loan officers who implement the management's decisions and their performance affects the institution's results. This justifies the constant attention bank managers pay to ensuring an appropriate context by way of sophisticated credit procedures, complex human resources policies, advanced technologies and good logistical support. While the individuality of each loan officer is being overshadowed by institutional factors, the context as well as the promotion of team work and ADOPEM values is also fundamental for loan officers to feel part of the institution.

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Research and Policy Briefs

Cette note s'inscrit dans le cadre du projet de recherche « Microfinance in crisis », financé par la Banque Européenne d'Investissement (www.microfinance-in-crisis.org). Cette série de Research and Policy Briefs a pour but de diffuser des travaux en cours, de nature empirique, méthodologique ou théorique

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