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Weaving Straw into Gold: Universalism meets Particularism in Microcredit

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Abstract

This study explores the relationship between universalism and particularism in the context of three microfinance programs in Mexico. Using a mixed-method approach, the study shows that certain loan officers frequently bend institutionalized rules to better address client needs. Through that discretion, they not only achieve better loan performance, but also increase the positive impacts of loans on clients. The study highlights how particularism can both produce better results and be instrumental for the improvement of organizational rules. The study also highlights the limits of particularism by showing that, for deviant practices to be effective, a balance between particularism and universalism must exist. High concentrations of rule-bending loan officers at the branch level are associated with *decreases* in loan performance. The paper challenges traditional definitions of particularism, the usefulness of the universalism-particularism dichotomy, and shows the interdependent nature of the two extremes.

[1] I am thankful to The Global Scholars Network and the Department of Political Science at MIT for funding this research. I also thank all the participants in the MIT BPS and Sociology of Strategy seminars for invaluable comments. I have also received very helpful comments on previous versions of this draft from Lotte Bailyn, Jim Baron, Suzanne Berger, Richard Locke, Michael Piore, Jesper Sorensen, Susan Silbey, Judith Tendler, John Van Maanen, Amy Wrzesniewski, and Ezra Zuckerman. I also thank Deborah Philippe for her valuable Research Assistance. All errors are my own.

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. (...) 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

Since Weber, the image of 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 discretion is constrained by efficient, universalistic decision rules that use equal, objective standards to avoid the pitfalls of subjective judgment (Parsons & Shils 1951; Maniha 1975; Weber 1978):

> Bureaucratization offers above all the optimum possibility for carrying through the principle of specializing administrative functions according to purely objective considerations (…) and "without regard for persons" (…) Calculable rules (are) the most important (element) for modern bureaucracy (…) it develops the more perfectly, the more it is "dehumanized", the more completely it succeeds in eliminating from official business love, hatred, and all purely personal, irrational, and emotional elements which escape calculation. (Weber 1978: p.973-975)

In contrast, and with increasing frequency, there is evidence that personal ties or relationships – impossible to capture in universal bureaucratic rules—can improve organizational performance through mechanisms such as joint problem solving, increased trust, and information sharing (Coleman 1988; Burt 1992; Uzzi 1996, 1997); that rule-breaking and experimentation can translate to increased effectiveness, innovation, and organizational evolution (March 1991); and that rules must sometimes be broken to avoid unfair, unethical, or unfavorable results (Lipsky 1980; Gilligan & Attanucci 1988; Heimer 1992; Thompson & Hoggett 1996).

These competing claims raise the central question of this paper: How do organizations handle the universal vs. the particular in providing services that are effective and fair?

At issue is our understanding of the nature of organizational rules. Universalistic rules exist because it is unclear to what extent organizations can rely on individuals –their judgment, relationships, knowledge, and resources provided by role assignments—to consistently make appropriate decisions. Given the limitations of individual experiences and the biases they generate, as well as the limits on human cognition, decision rules that are based on objective criteria can provide more reliable and defensible decisions than individual –arguably biased—

judgment (Maniha 1975; Meyer & Rowan 1977; Pfeffer *et al.* 1977; Dawes 1979; Dawes *et al.* 1989). Moreover, universalistic rules are more attractive for organizations because they are easier to implement, easier to justify, and cheaper to monitor and enforce (Weber 1978; Heimer 1992). The nature of rules and contracts is such that, for them to remain useful, there must be a credible mechanism to ensure that they are followed (Hart 1995).

At the same time, close relationships between exchange partners can generate trust that increases mutual commitment; provide nuanced information that cannot be coded in contracts; and result in more creative solutions that benefit both sides (Sabel 1993, 1994; Uzzi 1996). Moreover, especially in environments that present high levels of uncertainty, it may be unreasonable to expect rules to anticipate all possible situations. As a result, actors may not have an option but to rely on their personal judgment to make decisions. In such situations, following the rules exactly could result in sub-optimal –or even harmful—decisions (Lipsky 1980). In addition, if rules are always followed, experimentation with new practices will be limited and learning and innovation will be lost (March 1991).

The tension questions the accuracy –and usefulness—of the universalism vs. particularism dichotomy, which has resulted in a paradox best captured by Heimer (1992). On the one hand "...those who contend that organizations should be governed by universalistic rules are wrong because life in organization and networks necessarily entails obligations to concrete others" (p. 144) and we have seen evidence that organizations that understand this achieve better performance (c.f. Uzzi 1999; Ingram & Roberts 2000). On the other hand, one main function of bureaucracies is to create predictability and accountability by producing rules that regulate action, and particularism is both more unpredictable and "… an expensive virtue compared with universalism because it requires tracking individuals rather than categories" (Heimer 1992 p.145).

In few industries is this paradox more salient than in finance. The image of the local bank manager who knows all his clients by name and provides loans on a promise is well cemented at the heart of capitalist economies. At the same time, the growth of local banks into national giants, the increased competition between them, the wealth of information available from each client, and the increasing availability of technology have all pushed towards the automation of decisions through tools like credit scoring. And nowhere within finance are these pressures more visible than in microfinance.[1] Microfinance Institutions (MFIs) are inherently labor-intensive and labor-dependent, as they provide their services through loan officers that access and monitor a great number of atomized, small-scale clients (Morduch & Armendariz de Aghion 2005). This, together with their reliance on outside investors who have increasingly come to expect a set of standardized practices, has pushed MFIs to develop sophisticated tools that seek to increase the reach and scope of their services, keep a tight control on delinquency rates, and become more accountable to outside investors while maintaining a relatively nimble cost structure (Khandker 1998; Morduch 2000). At the same time, "soft" information that requires personal ties for its transmission is especially important for lending to small firms given their limited reporting infrastructure, the increased uncertainty of their business, and the high variance among clients who, on paper, would look the same (Berger *et al.* 2001; Berger & Udell 2002). Moreover, in most types of business lending, but more so in microcredit, most–if not all—of the interactions between clients and firms happen at a decentralized level, through branch managers and loan officers. These loan officers work in settings that mirror quite closely what Michael Lipsky describes as "Street-Level Bureaucracies". Under such conditions, Lipsky has shown, employees must be granted large degrees of discretion in the utilization of resources, the management of particular interactions, and the application of rules. This is partly because no set of rules can possibly anticipate or sanction all interactions (Lipsky 1980). Despite all this, the most cited works in microfinance, as well as the "best practices" that are disseminated, place an overwhelming emphasis on structural features of the programs as determinants of performance and have, for the most part, neglected the role of managerial and loan officer practices.

[1] In short, microfinance consists of the provision of financial services (mostly loans, referred to as microcredit) to previously unbanked populations. These services are built on the premise of allowing clients to make very 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 without secure collateral, so other mechanisms –such as networks or clients that secure each-other's loans—are used to guarantee payment. For good overviews of microfinance see Hulme, D. and P. Mosley (1996). Finance Against Poverty. London, Routledge, Morduch; J. and B. Armendariz de Aghion (2005). The Economics of Microfinance. Cambridge, MIT Press.

This paper uses microfinance[2] as a setting to show how universalism and particularism interact within organizations and that they are in fact mutually dependent. I will show that loan officers face such variability in the situations they encounter that no set of rules could possibly anticipate all of them. As a result, some loan officers learn to think of rules and contracts not as real constraints on their actions, but as tools that they can strategically use in the fulfillment of their jobs. Based on a deep understanding of their clients, these loan officers strategically bend rules to better fit their clients' needs. In so doing, they reduce delinquency rates, increase loan renewal rates, and avoid potential negative impacts for their clients. Moreover, these actors' successes in rule bending highlight some of the shortcomings -and result in an improvement- of the rules themselves. However, even in this setting where particularistic practices are especially effective, they are most effective when held in check by universalistic principles. Specifically, I will show that, in branches with a high concentration of rule-benders, performance actually *decreases*, and a balance between benders and strong enforcers of rules is desirable. This is for two related reasons. First, if all interactions are treated as exceptions, then no rule can retain its legitimate power. Second, branch-level interactions between different types of loan officers result in increased learning opportunities as well as an increase in the standards of universality that exceptions must meet to remain productive. To my knowledge, this is the first study that empirically documents variation in practices within a particular context and shows that one form is not simply a degenerate of the other, but that both forms actually coexist and depend on one another.

The paper is structured as follows: I will first provide a brief review of the relevant literature. Second, I will describe the data and the methods. In the third section I will use the qualitative data gathered through months of fieldwork to generate a series of broad theoretical propositions on the relationship between universalism and particularism in a setting like microcredit. I will later use a series of quantitative data to test these propositions and gain additional insights into the mechanisms that drive them. The paper ends with a discussion of the results and some concluding remarks.

[2] Throughout the paper, I use the terms microcredit and microfinance interchangeably. Strictly speaking, the former is a subcategory of the latter, which can also include other financial services like microinsurance or savings. For most MFIs, however, microcredit represents the totality or the vast majority of their activity.

Universalism and Particularism in Organizations

In her 1992 chapter, Heimer brings to light the seldom-recognized paradox of rules in organizations: there is an inherent tension between the universalistic principles that should be at the heart of every rule in a bureaucracy and the reality that "only by 'helping friends' can anyone ever do business". Broadly, particularism has been used to describe situations where the social commitments generated through a personal relationship overpower norms of fairness or "objective" evaluations in work decisions. But this seems different from the positive impacts of "embedded" relationships, in that

> particularism need not entail judgments made in the light of *what kind* of relationship one actor has with another, but only information that one actor has about another *as a result* of a joint history. (Heimer 1992: p.146, emphasis added)

Put differently, particularism is problematic as an overarching label because there seem to be different ways in which "personal and relational elements which escape calculation" (Weber 1978) can enter an organizational decision, some that are productive, some that are not. Organizational decisions that diverge from universalistic rules *because* a personal relationship is present can indeed be damaging. But this behavior does not fully describe how personal relationships can affect organizational choices. There seem to be at least four different levels in which particularism can seep into universalistic rules, with increasing levels of questionability:

1. An actor can use the private information obtained through personal relationships to better quantify the elements already defined in universalistic rules and improve their accuracy. In the context of small business lending, for example, a branch manager might know that a credit applicant is the son of a wealthy landowner and can provide significantly more collateral than a traditional credit analysis of his business would suggest. In this case, the actor is using the relationship to correct a *measurement error* that could misinform *existing* rules.

2. An actor might learn that, even though the rules are appropriately quantifying the information of an object, they are leading to an unfair or unreasonable result. Put differently, through her personal experiences and her private relationships, an actor might learn additional information that suggests that the rule should not be applied in a particular setting. For example, when an academic department is about to decide on a faculty promotion, one committee member might know that the professor in question suffered from a debilitating illness for an entire year and her productivity should therefore be judged differently. In this case, the actor is using the relationship to learn that the rules are *missing a relevant category*.

3. If a change occurs in the environment or the heterogeneity of the objects is larger than the rules anticipate, an actor can use the information gained through personal relationships to understand where rules are improperly specified, where they are wrongly calibrating quantifiable data, or where the categories are simply not capturing the relevant heterogeneity in the environment.

4. Finally, an actor can allow the personal commitments or personal *preferences* derived from a personal relationship to affect how she implements a rule. For example, she may withhold certain information about her cousin that would result in an automatic exclusion by the rule.

In other words, some forms of particularism use *the additional information* gathered *through* a personal relationship to make decisions that are *better* aligned with organizational goals, even if they diverge from written rules. Such particularism places

> ...a stress on the particular features of the object *itself*, rather than on one's *own* particular characteristics or of the object's standing (as Parsons and Shils put it) in its relation to oneself. (…) In addition, "good" particularism entails skill in seeing the general in the particular. (…) (It) can be justified to a third party by showing what potentially universalistic category the object belongs to." (Heimer 1992: p.153)

This suggests that, rather than choose between universalism and particularism, organizations – especially those that interact intensely with clients—experience constant tension both between the two extremes *and* between productive and unproductive types of particularism. Successful organizations must therefore develop mechanisms to resolve the tensions and provide services that are effective and fair. For example, will an employee who understands the value of particularism know when she has gone too far? The false dichotomy between universalism and particularism, as well as the lack of clarity with which particularism has been treated, have limited the extent to which these tensions have been fruitfully explored. To date, existing studies either highlight the value of universalism (c.f. Dawes *et al.* 1989), underscore the impossibility of universalism (c.f. Lipsky 1980), or highlight the virtues of particularism (c.f. Uzzi 1999). But we have little guidance on how organizations actually manage the continuum and the tensions that arise from it. While Heimer provides useful conceptual tools, it is difficult to imagine how such tensions would coexist in a real-life organization, let alone how they would actually be managed. As we strive to understand how rules emerge, how they function, and how they evolve, it is central to deepen our understanding of how the tensions inherent in any rule system develop and are fruitfully resolved.

Microcredit and the Paradox of Universalism

Microcredit presents a unique setting to explore the inherent tensions between universalism and particularism in organizations. Microfinance Institutions (MFIs) are under extreme pressure to institutionalize organizational procedures that follow "best practices" as expected by donor and investor networks. MFIs emerged with the intention to provide underprivileged populations with a more beneficial financing mechanism than popular options such as loan sharks, informal savings groups (or ROSCAS), or previous microlending programs run by governments with political goals in mind. Accordingly, MFIs have developed sophisticated technology that allows them to increase the reach and scope of their service offering while maintaining a relatively nimble cost structure. These tools include detailed credit-scoring models, statistical tools that provide actuarial judgment, and hand-held devices that loan officers can use in the field to access information in real time. This is especially important because MFIs are inherently labor-intensive and labor-dependent, as they service often remote, often rural populations and provide their services through loan officers that access and monitor a great number of atomized, small-scale clients (Morduch & Armendariz de Aghion 2005).

In addition, as NGOs, MFIs initially could rely only on donors –and retained earnings if available—to fund their growth (Marulanda & Otero 2005). This generated a dual pressure –from their need to fund their own growth and their dependence on donors—to adhere to strict norms of efficiency and profitability with a narrower focus on 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 that appealed to investors. This resulted in additional pressures to install complex accounting and managerial systems, as well as to conform to international standards and best practices (Morduch & Armendariz de Aghion 2005). With the success of increasing numbers of MFIs, private investors flowed in bringing increased market awareness[3] and, as microcredit increased its relative weight, federal and local regulators also increased their oversight. An example of the pressures to conform is the number of international organizations and associations that constantly track MFIs around the world to provide periodic reports of best practices and benchmarks.[4] Investors and donors have come to rely heavily on these benchmarks to judge potential investments, and increasingly demand that MFIs adopt similar lending structures across markets (Dugan & Goodwin-Groen 2005).

However, given the localized nature of microfinance, the large differences that are bound to exist between contexts, and the central role that loan officers play in the lending process, at least some

[3] A recent, highly 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 as two of the most prominent examples.

degree of decoupling between universal, internationally defined rules and local practices is likely to occur. That means that only analyzing written rules would both miss the large potential variance contained in diverging (actual) practices, as well as ignore the endogenous causal link between current practices and future rules. A better understanding not only seems necessary, but also requires an approach that does not take written rules as facts but rather questions them, and treats rules and practices as endogenously interrelated as well as significantly decoupled (Ewick & Silbey 1999; Silbey 2005).

Data and Methods

To address the questions of how rules and practices interact in microfinance, this paper combines qualitative with quantitative evidence to explore the interactions between MFIs and clients. I performed a mixed-method analysis of three MFIs in Mexico to untangle the relationship that clients and loan officers have with MFIs. Given the complexity of the phenomenon, I place particular emphasis on qualitative methodologies, following a grounded theory-building approach (Glaser & Strauss 1980). I also explicitly straddle different levels of analysis, going from organization-wide rules and policies, to branches and branch managers, to actual interactions between loan officers and clients. Because the paper explores how field-level practices affect lending outcomes, the research design seeks first to understand within-firm variation, or the mechanisms that explain differentials in performance across branches and across clients of the same MFI, to later look for patterns across different MFIs. Accordingly, the basic choice of organizations was made to learn more about the particular professional and managerial practices that develop in the MFIs, how those practices depend on and influence structural design features, and how they relate to MFI performance. I worked with one company (FC) 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).[5] I picked

[5] There are three basic lending methodologies in microcredit: communal banks, solidary groups, and individual loans. Communal banks are by far the most widespread of the three and were promoted by the inventor of microfinance and founder of the Grameen Bank in Bangladesh, Muhammad Yunus. The idea is that groups of at least twenty and as many as fifty clients come together and collectively request a loan. They are self-regulating and self-enforcing as a group and are all collectively responsible for the repayment of the loan, even though the loans are distributed individually inside the group. Solidary groups are much smaller groups (from three to five, sometimes a few more) and are also collectively responsible for the loans, but the loans are given directly to the individuals as opposed to the group, and the groups are not self-regulating. That is, each client in a solidary group undergoes a separate credit analysis and the interaction between the bank and the client is not at the group level (as in communal

these companies because, even though they have different structural characteristics they are all profitable, have been so from their origins, and have all been recognized by international organizations as leaders with orthodox practices. The mixture of companies allows for the comparison between individual and group lending methodologies, as well as the practices that develop inside each of them. Similarly, they highlight differences between urban and rural environments. The focus was therefore to use within-firm variation to disentangle the mechanisms that drive loan behavior to detect whether those same mechanisms traveled well across different lending structures.

INSERT TABLE 1 ABOUT HERE

I spent over five months collecting qualitative data within these companies, and several months doing routine follow-up interviews. A majority of the time was spent with FC (around 60% of my total time), where the initial findings emerged. I repeated the methodology extensively with FR (around 30% of my time). Finally, CG was used as a validation case (the remaining 10% of my time). I divided the qualitative part of my work in two phases within each company. In the first phase I interviewed MFI employees, starting with the CEO and slowly working my way down the organization until I reached the loan-officer level. During this phase I also observed several loan officer-client interactions and sat in several internal meetings. The findings from this phase allowed me to structure the subsequent steps, which entailed interviews with branch managers and loan officers. To do this, I asked interviewees from the central office to place branches in three groups: good performers, average performers, and poor performers. The categorization was highly consistent across employees within each of the companies, 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. Once I reached the branches, I spent between half a day and a whole day visiting the branch, talking to the manager, attending committee meetings and sitting in on manager-client and manager-loan officer interactions. Subsequently, at the end of the branch visit, a sample of loan officers was picked at random with

banks) but at the individual level. The group, however, is used as “social collateral” for the loan. Individual loans are self-explanatory.

the assistance of the branch manager. I interviewed just over 50 employees. In the second phase of the study, I performed client interviews. To pick clients, I asked the officers to give me a list of their clients and I randomly selected four or five. I also asked officers to select for me one of their best clients and one of their worst clients to ensure variation. In total, I performed just over 50 client interviews.

To complement the fieldwork and test the propositions generated through it, I used FC's databases, which contain detailed information on their clients, their loan officers, and loan behavior. In particular, I used three separate databases. The first contains client information gathered during credit analyses between 2000 and 2003. It contains information on family income, type and quality of housing arrangements, available services, family characteristics (number, age, and education of children), and several other socioeconomic indicators. This information was gathered when clients applied for a first loan, when they renewed their loan for the first and second times (that is, before the second and third loans), and then every time an increase larger than 30% was requested on a loan amount. The database therefore covers thousands of clients over several years, and includes several records per client.[6] The second is a comprehensive dataset of all the loans provided by FC between 2000 and 2008, with quarterly updates on the performance of each loan. The database contains information on close to 450 thousand loans granted to over 60 thousand clients (many clients have held several loans over the years). It contains information on loan size and characteristics, the responsible loan officer, interest rate, payment behavior, as well as individual information on each client and her business (assets, sector, etc.). The third is a database that contains the performance bonuses paid to all loan officers between 2000 and 2008. In the three companies that I observed, and in most MFIs, loan officers are paid through a mixture of fixed and variable compensation. The variable component takes the form of a bonus, which is carefully designed and calculated according to the metrics that the organization cares most about. In particular, the bonus takes into account, in order of importance: delinquency rates, new loan placement, total amount lent, loan renewal rates, and product cross selling.

[6] The data stop in 2003 given that the company changed reporting systems and the credit analysis data is no longer available in usable format.

Propositions

Universalism and Particularism in MFIs

Proposition 1: *In settings like microcredit that present high uncertainty and require intense client interaction, the variation in field-level practices will result in large performance differentials within the same organization.*

Proposition 2: *In settings like microcredit, particularism will be productive for the organization.*

> ***Proposition 2a:*** *Agents who engage in particularistic practices will tend to outperform agents who don't.*
>
> ***Proposition 2b:*** *In these settings, the particularistic practices followed by agents will mostly be of productive kinds.*

Proposition 3: *Particularism has a non-linear relationship with organizational effectiveness. The more particularistic practices that are implemented, the more likely that they will become detrimental to the organization.*

Proposition 4: *The balance between universalism and particularism is best struck at the organizational unit level. Organizational units that create a balance between the number of universalistic and particularistic agents will be the best performers.*

Test of Theoretical Propositions

In the observation of loan officers and their interactions with clients, managers, and peers, I found that certain officers systematically bend rules while others tend to adhere quite strictly to them. Through these observations, I inductively developed a typology of loan officers, which will guide the rest of the paper. Table 2 shows the different rules and guidelines that are designed to shape relationships and the ways in which the two types of officers apply them. It is naturally not the case that *all* officers can be perfectly defined by one type. Rather, each category can be thought of as one of two extremes in a continuum, with each officer placed somewhere within it. "Spirit of the Law" (SL) officers tend to have a flexible interpretation of the rules. They see them as tools, not as binding constraints. To complement what they see as imperfect policies, they develop personalized relationships with their clients to know as much about them as possible. This is not necessarily out of altruism, but because as officers, they believe that these relationships allow them to perform better.

INSERT TABLE 2 ABOUT HERE

In contrast, "Letter of the Law" (LL) officers tend to be strict rule followers and usually do things by the book. To deal with the uncertainty they face, these officers refer to company policies when making decisions to limit their choices.

In this section, I will use the array of quantitative data described above to test each of the propositions. Table 3 presents a list of the different variables used, a brief description of each one, and some basic descriptive statistics.

INSERT TABLE 3 ABOUT HERE

Proposition 1, Within Firm Variation

The baseline proposition (1) established that, in microcredit, there should be large differences in within-firm performance metrics. Table 4 presents a representative sample of FC branches with some key performance metrics. It can be seen that there is significant variation between branches in the metrics that FC uses to measure performance like delinquency rates and growth in loaned amounts. Within-firm variation can also be seen in the impact that loans have on clients, measured as increase in household income between loan cycles, which is at the heart of most MFI's missions. A first reaction would be to think that certain branches are situated in wealthier regions, where clients can better afford to repay loans, or that there is something about a particular region that has created a better "payment culture" among clients. Evidence does not support these claims. First, there is not a significant difference between the mean or median income of clients across branches. Second, the relationship between income and performance seems to point in the opposite direction that we would originally expect, as can be seen in the correlations provided. Third, branch numbers are assigned according to regions. Thus, branches 25 and 26, or 31 and 32 are actually situated in very close proximity to each other with substantial overlap in their coverage areas, and yet they present some of the starkest differences between them. Moreover, table 3 also shows that performance between individual loan officers also varies greatly, as can be seen in the broad distribution of bonus payments.

INSERT TABLE 4 ABOUT HERE

Proposition 2. Effectiveness of Particularism

As I mentioned above, MFI employees believe that differences in branch performance stem solely from field-level practices. In particular, I earlier documented how loan officer practices diverge, and I created a typology that describes systematic differences in loan officer behavior along the interpretation and enactment of rules. Proposition 2 argues that more particularistic loan officers should outperform universalistic types. To look for systematic differences in loan officer performance and to validate my typology, I presented it to the three regional managers that are in charge of supervising branch managers and loan officers at FC. These managers interact with loan officers intensely, and they know all of them well. I asked each 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. Managers performed their coding independent of each other. As primer, I only showed them table 2, and stressed that the types had nothing to do with performance but with operating style. After making them familiar with the typology, I would read a name from the full list of loan officers and they would place that name in a category. When an officer could not be easily placed, she was coded as “undefined”. Inter-rater reliability was just below 80 per cent. There was no instance where one manager coded an officer as SL while the other coded her as LL. The only discrepancies were between a type and an undefined officer. Where discrepancies were found, I coded those officers as undefined.

To address Proposition 2a, which states that loan officers who engage in particularism should outperform those who do not, Table 5 presents basic information on the bonus earned by different loan officer types, as well as their relative distribution in the loan officer population. This is a useful metric to use for two reasons. First, the bonus system has been developed by each MFI to reflect the behavior they expect from loan officers. Accordingly, the monthly bonus represents a significant portion of their salary (up to 230% of their base salary) and is calculated through a point system that includes delinquency rates, total amount lent, client renewal rate, and new client acquisitions. Second, bonus systems are remarkably similar across the three MFIs I studied, which further validates their legitimacy as a performance metric.

INSERT TABLE 5 ABOUT HERE

In accordance with Proposition 2a, SL officers, who systematically bend the policies that were presumably designed to help them do a better job, tend to outperform their peers. We can see in the table that both mean and median bonuses are significantly higher for SL than for their peers. At the same time, both SL and LL officers outperform undefined officers (more on this later). It is important to note that all types are represented in the top and bottom percentiles. The top LL officers, for example, perform above the 95th percentile, while the bottom SL officers perform below the first percentile. To explore this further, Table 6 presents multivariate analyses that use Bonus as a dependent variable. The regressions are made using FC's database of loan officer performance over the years.

INSERT TABLE 6 ABOUT HERE

Linear regressions show that, on average, SL officers tend to earn 20 percent higher bonuses than other loan officers. This difference persists even after controlling for the average characteristics of each loan officer's client pool. This suggests that, while loan officers who on average grant loans at higher percentage rates or manage to increase loan sizes more perform better, SL officers outperform their peers even when granting loans in similar terms. This puzzle begins to address Proposition 2b, which has to do with the kinds of particularism exhibited by SL officers.

Two different mechanisms could account for the difference in officer performance: client selection and monitoring. Table 7 presents results from a series of multivariate analyses of loan defaults. The dependent variable is whether a loan was delinquent. All models include branch and year effects. I used a logistic regression given that nature the dependent variable. Model I shows that, controlling for the type of loan and other client characteristics, loans managed by both SL and LL officers tend to perform much better than those managed by "undefined" officers. At the same time, LL officers perform slightly better than SL officers in terms of delinquency rates. This would suggest that SL officers are indeed taking larger risks than LL officers, but not in ways that damage the firm. Restructured loans provide additional evidence of this.

As could be expected, loans that have been restructured are much more likely to become delinquent. Interestingly, Model II shows that if a SL officer handled the restructuring, the loan performs much better than if it was handled by any other type. In fact, the odds of delinquency for a restructuring performed by a SL officer are 147 percent larger than non-restructured loans (48 percent likelihood of delinquency).

INSERT TABLE 7 ABOUT HERE

These results suggest that, while SL officers take larger risks when they select clients, they are also better at handling their clients on a day-to-day basis, especially once they are in trouble. As I mentioned, MFIs have instituted random officer rotations to reduce the potential of inappropriate officer-client relationships. The impact of these rotations on loan delinquency rates provides additional insights into the kinds of ties that are normally built between officers and clients.

INSERT TABLE 8 ABOUT HERE

Regressions in table 8 show that, when a loan officer is transferred, a loan is much more likely to become delinquent. Interviewees believed that delinquency spikes were due to the broken tie between the officer and the client. This would explain why SL officers, who rely more on their personal relationships with clients, tend to create smaller delinquency spikes when they leave a branch. Notice, however, that clients of LL officers are also resenting the broken tie, which indicates that, while SL officers *use* their relationships differently, both types of officers *establish* relationships with clients.

Model III presents additional evidence of this. The model includes dummy variables to account for changes from and to different types of officers. Compared to the omitted category of changes from an undefined loan officer to another undefined loan officer, changes within the SL or LL types do not experience a spike in the probability of delinquency. At the same time, the largest increase in probability occurs when any other type replaces a LL officer, followed by changes from LL to other types. It is also worth noticing that transferring from an undefined officer to *any* type is less disruptive. This suggests that, while the existence of a personal relationship is evidenced by the disruption that clients experience when the tie is broken, clients become accustomed to a particular *type* of relationship with their loan officer, and experience a disruption when that relationship is changed.

Propositions 3 and 4. Limits of Particularism

The analyses in table 9 include branch level indicators. Model I shows a first indicator of branch level influences: a lagged percentage of delinquent loans at the branch. We can see that, when a branch has had a higher percentage of delinquent loans, subsequent loans are more likely to miss payments. Model II explores how the concentration of particular loan officer types at a single branch affects results. It shows that, even though SL officers tend to perform better than LL officers, a higher concentration of the former does not affect branch performance while a higher concentration of the latter does improve it. Model III provides additional insights. A small concentration of SL officers actually enhances performance, but the effect is highly non-linear. The same cannot be said for LL officers. Finally, Model IV shows a highly negative and significant coefficient for the interaction between the concentrations of the two types of loan officers, which indicates that a balance in their relative percentages is best.

Two separate mechanisms, corroborated during interviews to branch and regional managers, explain this. First, when too many officers constantly make exceptions for clients, then

> …exceptions become the norm, loan officers jump over fences and they start taking decisions that they just don't have the authority to take. If this happens, the system starts to break down. (Zone manager, FC)

When clients encounter one loan officer who seems to make exceptions, they can attribute the exceptions to the individual.

The second, stronger mechanism has to do with how decisions are processed at each branch. As I mentioned before, all credit decisions are processed at the branch level, through credit committees. As SL officers bring proposals to their branches, it is hard for them to gauge when the exceptions they propose for clients might overstep justifiable boundaries. If there are other officers who are rule oriented and push back, it forces exceptions to meet a standard that they might otherwise miss. The opposite is naturally also true. When LL officers miss instances where rules fail, their SL peers can push them to behave more fairly. This balance between the different types creates additional diversity and increases the amount of information and the speed with which it is shared, which can significantly increase learning (c.f. Eisenhardt 1989; Eisenhardt and Martin 2000; Repenning and Sterman 2001, 2002). To further validate this finding, during my follow up interviews I asked ten zone and regional managers in FC (all of whom have had years of experience as branch mangers before being promoted) to describe what the ideal branch would look for them. I asked them to name specific loan officers (past or present) that they would like to recruit, and after they named them, I asked them to describe the qualities of each officer, and why they would be a good part of the team. The following response is highly representative:

> 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. (…) Then I would say "J", he is a true service person. He always thinks of what his clients need, (…) he knows everyone in the community (…) he is the best salesman. Third, I would add "A", she 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 our clients. Finally, I would add "R", he 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 pressures others in his branch to improve their analyses.

In fact, every single one of these interviewees created an ideal branch that mixed different types of loan officers as described above.

Discussion

SL officers play an instrumental role within MFIs. Through their understanding of the particular needs of their clients and the limits of organizational rules they can enhance the potential impacts of a loan, achieve better performance, and underscore the shortcomings of existing rules. In loan defaults, for example, SL and LL officers and managers often clash over how to handle the situation. I observed two instances where branch managers suggested sending a loan to the legal department for collection but met with strong resistance from loan officers, who eventually sought the regional manager to approve a restructuring. For these SL officers, it was not acceptable to pressure their clients, as it represented an unfair solution that only made matters worse. Having learned through personal ties that their clients were trustworthy, these loan officers were not willing to break that trust by engaging in unfair behavior.

SL officers also enhance organizational learning through their previous experiences, personal acquaintances, and prevailing characteristics, all of which are particularly useful in service organizations. The uncertain conditions present in the microcredit environment increase the value of employee discretion, flexibility, and on-the-spot decision making, as well as their impact on organizational learning. More broadly, when SL officers engage in experimentation by proposing alternative explanations to a particular signal –such as a missed payment, they learn new information that is unavailable to LL officers who have no way of experiencing the outcome of such experimentation. This means that a branch where "Spirit of the Law" officers are present is likely to be a more effective learner than one where they are not. In addition, loan officers who better understand client needs can transfer that knowledge to their managers. In the right environments, officers are bound to shape and modify branch-level practices through selective issue-selling activities. Good loan officers can have a great influence on managers who, in turn, can sell some of that learning to upper management, thus improving company-wide policies. In the process, the boundaries between clients and MFIs are redrawn in constructive ways in a setting where marginalization and exclusion could be an equally plausible outcome.

As I have argued throughout the paper, SL officers are clearly engaging in particularistic practices, but they seem to be of a specific type. In general, particularism is condemned because it is implied that decisions will be made *because* there is a relationship present and different standards will be adopted for different people (Rawls 1996; Thompson & Hoggett 1996; Pearce *et al.* 2000). But the evidence presented here confirms that the traditional understanding of particularism is both incomplete and misleading. Particularism often provides valuable information that can only be obtained through a personal relationship and uses it to make choices *based on universalistic principles* (Heimer 1992). That is, there is considerable difference between breaking a rule so I can help a cousin and breaking it because I understand the principle behind it and, based on the additional information I obtained through a relationship, I know that applying the rule would actually go against that very principle (Thompson & Hoggett 1996). This distinction requires a more nuanced understanding of the types of particularism that can exist, as well as of the relationship of interdependence that exists between universalism and particularism. General ("blind") universalism can easily confuse impartiality with uniformity and *equality* of treatment with *sameness* of treatment. That is, focusing blindly on universalism does not distinguish between partiality and sensitivity to social differences. It also fails to acknowledge that particularism can be good when it focuses on differences between individuals –or smaller categories—that make a *relevant* (moral, strategic) difference (Heimer 1992; Thompson & Hoggett 1996).

At the same time, even "well intentioned" particularism has its limits. When all decisions are based on particularistic factors, systems can quickly break down into untenable relativism. For an organization to learn, experimentation must happen in its core practices. But a set of stable practices must still exist to retain that learning (March 1991, 1996). In addition, rules can only retain their legitimacy when they are actually enforced and when, in the aggregate, they are seen as fair, impersonal, and universal. This is why the balance between rule-benders and rule-enforcers is important. When all cases are treated as exceptions, all rules become relative and no rule can retain its legitimacy (Silbey & Ewick 1998; Silbey 2005).

Conclusion

I do not intend to imply that loan officer practices –and especially "Spirit of the Law" practices—are the only key to MFI performance. The companies I analyzed have spent many years devising a set of policies and operational systems that have allowed them to standardize operations, reduce costs, and provide a complex service effectively. They have created sophisticated –and effective—incentive schemes to monitor their employees, particularly loan officers. They have refined their service offering to make loans increasingly attractive to clients. They have devised strict practices to make sure that loans match the clients' payment capabilities. They have established effective collection practices that have reduced delinquency rates to impressive levels. What I argue is that loan officers matter, and they matter a great deal. By understanding, acknowledging, and addressing their clients' needs certain loan officers have managed to reduce delinquency rates, increase loan renewal rates, and avoid negative impacts for their more destitute clients. These officers do not ignore company policies. Rather, they use them as guidelines to facilitate their work. This means that MFIs should pay much more attention to loan officer practices to deepen their understanding of the determinants of performance and to continuously improve their policies. The fact that formal policies are not always applied to the letter and are in fact routinely bent by top performers questions the validity of a blind focus on contractual structures as a level of analysis. I also do not intend to imply that more discretion is necessarily better, so we should do away with rules, policies, and structures. Company policies are an indispensable requirement to guide and motivate employee behavior. I simply argue that discretion is unavoidable, especially in certain contexts, regardless of the quality of existing rules. Managers should be aware of this fact to steer discretion –which is inevitable—in fruitful directions. For example, rigid policies that do not allow for client contingencies might only worsen a client's situation and the company's prospects of recovering a loan. The mechanisms that steer those contingencies in productive ways emerged out of and can only function in the context of well-guided loan officer discretion.

The role that "Spirit of the Law" officers have had in shaping and improving MFI rules should be noted. Through a flexible interpretation of company rules, these officers have entrepreneurially applied them to achieve more efficient outcomes than the structure would allow. Moreover, through their outstanding performance and their issue-selling activities, they have been able to institutionalize certain practices into improved policies. This provides additional insight into the interdependent relationship that exists between particularism and universalism, discretion and enforcement, and deviance and compliance.

Tables

Table 1 – Lending Methodologies and Geographic Focus by Company

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

Table 2 – 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 3 – 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
Officer Change	Dummy Variable. Takes the value of 1 if the client experienced a loan officer change in the life of the loan	0.253	-	0.435	0	1
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

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

Table 4–Some Key Metrics by Branch (FC)[§]

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%**	22.40%**	6.20%	1.60%**	2,315	1,720
21	7.14%*	17.90%**	6.00%**	8.00%*	2,496	1,804
22	4.05%**	10.40%**	11.20%**	21.80%	2,542	1,827
24	3.48%**	10.10%**	9.20%*	25.80%**	2,200	1,704
25	10.00%**	19.10%**	0.80%**	22.00%	2,362	1,641
26	7.90%*	7.90%**	8.00%	24.00%*	2,050	1,530
31	7.82%	17.80%**	3.30%**	23.00%*	2,583	2,156
32	5.16%**	5.16%**	14.40%**	5.00%	2,089	1,597
41	5.52%**	11.70%**	4.60%**	14.00%	2,070	1,590
42	5.93%**	15.00%**	11.70%**	16.00%	2,145	1,678
43	8.14%**	17.40%*	-0.90%**	6.00%**	2,268	1,833
51	8.68%**	20.70%**	10.70%*	2.00%*	2,314	1,724
52	8.57%**	19.70%**	-7.10%**	55.00%**	2,287	1,844
61	6.38%*	10.50%**	10.30%	0.70%	2,105	1,589
Overall[4]	7.51%	16.31%	7.82%	17.00%	2,342	1,768
SD	2.11%	3.77%	6.72%	38.18%	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 FC 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 FC branches not just the sample.

Table 5 – Bonus Performance by Loan Officer Type

Officer Type	Mean	Median	Min	Max	SD	N[a]
Spirit of the Law	1.27**	1.22**	0.19	2.66	0.51	24
Letter of the Law	1.06**	1.07**	0.20	2.07	0.47	24
Undefined	1.02	1.01	0.14	2.77	0.50	27
All Officers	1.11	1.11	0.14	2.77	0.51	76

** Differences between types significant at 0.05 level.

[a] Numbers calculated based on the population of loan officers coded by managers.

Table 6 – Linear Regressions on Earned Bonus

Model	I	II
D.V.	Bonus	Bonus
Spirit	0.187***	0.192***
	[0.0564]	[0.0669]
Letter	-0.0341	-0.0471
	[0.0592]	[0.0638]
Change	0.0709	-0.0767
	[0.0573]	[0.0601]
Frequency		0.00211
		[0.0114]
Loan Amount		0.27
		[0.215]
Payment Amount		-0.318
		[0.212]
Interest Rate		3.788***
		[1.370]
Female		0.168
		[0.214]
Group		-0.0696
		[0.190]
Firm		6.601
		[8.328]
Previous Delinquency		0.322**
		[0.163]
Restructured		-0.676
		[3.116]
History of Late Payment		-0.538**
		[0.213]
% Change in Amount		0.257***
		[0.0812]
Intercept	0.0921	-16.97***
	[0.0768]	[6.001]
Observations	830	815
R-squared	0.33	0.34

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.

Table 7 – Logistic Regressions on the Probability that a Client Will Miss a Payment

Model	I	II
D.V.	latepmt	latepmt
Frequency	-0.00655***	-0.00656***
	[0.000516]	[0.000516]
Loan Amount	0.941***	0.940***
	[0.00803]	[0.00803]
Payment Amount	-1.047***	-1.047***
	[0.00983]	[0.00983]
Interest Rate	6.725***	6.725***
	[0.0509]	[0.0509]
Female	-0.0911***	-0.0912***
	[0.00769]	[0.00769]
Group	0.155***	0.155***
	[0.0102]	[0.0102]
Firm	1.362***	1.362***
	[0.262]	[0.262]
History of Previous Delinquency	0.389***	0.389***
	[0.00410]	[0.00410]
Spirit	-0.390***	-0.388***
	[0.0119]	[0.0119]
Letter	-0.492***	-0.493***
	[0.0169]	[0.0170]
Restructured	1.270***	1.303***
	[0.0488]	[0.0536]
Restructured * Spirit		-0.336**
		[0.151]
Restructured * Letter		0.126
		[0.243]
Intercept	-35.68***	-35.68***
	[0.566]	[0.566]
Observations	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 8 – Logistic Regressions on the Probability that a Client Will Miss a Payment –Loan Officer Rotations

Model	I	II	III
D.V.	latepmt	latepmt	latepmt
Officer Change	0.337***	0.581***	0.0566**
	[0.00836]	[0.0199]	[0.0222]
Change from Spirit		0.0148	
		[0.0273]	
Change from Letter		0.0945***	
		[0.0298]	
spirit_spirit			-0.320***
			[0.0745]
spirit_other			0.400***
			[0.0698]
letter_letter			-0.207**
			[0.0991]
letter_other			-0.0608
			[0.0704]
undefined_spirit			-0.123**
			[0.0629]
undefined_letter			-0.435***
			[0.0889]
Intercept	-36.91***	-42.30***	-41.08***
	[0.567]	[1.058]	[0.822]
Observations	144,452	144,452	144,397

Robust standard errors in brackets -- Errors clustered at the client level. Clustering at the branch level generated the same results.
NOTE: The regression included the same controls as previous regressions, but they were not reported for brevity purposes.
All models include branch and year effects.
*** p<0.01.
** p<0.05.
* p<0.1.

Table 9 – Logistic Regressions on the Probability that a Client Will Miss a Payment –Branch Level Indicators

Model	I	II	III	IV
D.V.	latepmt	latepmt	latepmt	latepmt
Lagged Branch Delinquency	0.0408***	0.0437***	0.0440***	0.0440***
	[0.000290]	[0.000468]	[0.000474]	[0.000474]
Branch % Spirit		-0.0795*	-1.405***	0.178***
		[0.0476]	[0.196]	[0.0567]
Branch % Letter		-0.175***	-1.122***	-0.154
		[0.0554]	[0.188]	[0.0955]
% Spirit Squared			0.419***	
			[0.126]	
% Letter Squared			-0.197	
			[0.181]	
% Spirit * % Letter				-0.968***
				[0.247]
% Letter * % Undefined				0.616***
				[0.238]
Intercept	-35.74***	-36.65***	-35.84***	-36.31***
	[0.497]	[1.340]	[0.670]	[1.341]
Observations	144,230	144,230	144,230	144,230

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

NOTE: The regression included the same controls as previous regressions, but they were not reported for brevity purposes.

All models include branch and year effects.

*** p<0.01.

** p<0.05.

* p<0.1.

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