

CONTROLLING GROWTH AT A MEXICAN MICROFINANCE START-UP¹

Hidalgo, Mexico

Esperanza Ortiz drove rapidly down the dusty highway barely noticing the flocks of fluffy gray sheep basking in the October sunshine. Her thoughts were centered on a troubled branch of her microfinance organization, Mujeres Unidas de Mexico, which she had joined as Director just three months earlier.

Esperanza was in a particular hurry to get to the branch because this was her last opportunity to visit the distressed loan center – the source of the fraudulent loan problem – before her trip to New York. She wanted to cancel her trip, but she knew she could not miss the Board meeting of Mujeres Unidas International, the umbrella organization of her microfinance organization. She had follow-on plans to attend a major microfinance conference where donors and directors of microfinance organizations gathered once a year to discuss relevant themes in lending to the poor and to refine their skills through professional development seminars.

Ghost Encounters

Esperanza parked in front of the Mujeres Unidas branch, walked to the front entrance and ducked down to enter the small door of the two-story building. Her stomach turned as she noticed the worried looks on her employees' faces and the anger on the faces of many clients. She overheard one woman say to a loan officer: "I want to return my loan. I never knew anything about having to come to meetings to pay it back."

Esperanza had come to the branch to attend the first weekly meeting of Mujeres de Futuro (Women of the Future), a group of borrowers from this branch. Meetings were held weekly so clients could make payments on their loans and often attend a training session. Mujeres Unidas gave out three-month initial loans of up to 1300 pesos (approximately US\$130) to women in targeted

communities to help them start their own businesses or increase the size of their existing small businesses.

No collateral or deposit was given, but the women needed to join with at least 4 other women in their community to guarantee their loan as a "solidarity group." Mujeres Unidas required that 4 or 5 of these solidarity groups integrate to form a Solidarity Association of approximately 25 women. If one of the women failed to pay, the other women in their group were obligated to cover the missed payment. In this way, Mujeres Unidas hoped women would select for their group their most responsible peers – people who would invest their loan wisely and repay on time.

As Country Director, Esperanza did not regularly attend loan repayment meetings in the branches. She came to this one to see for herself the impact of the fraud committed by one loan officer who had damaged not only this association but also the branch as a whole.

Two hours later, Esperanza exited the branch exhausted and disheartened. Of 30 women in this Association, 3 were receiving loans in the name of other women and 9 supposed recipients of 1300 peso loans had received no funds at all. It was very clear that one of her loan officers had enrolled "ghost clients" by obtaining election credentials and proof of address documents, registering them as "new" Mujeres Unidas clients and falsifying signatures.

The nine ghost clients in this Association brought the total number of fraudulent loans issued by this loan officer to twenty-five. The loan officer had developed a scheme by which she kept the proceeds of loans issued to these ghost clients for her personal use, then repaid the loans using the proceeds from new fake loans. With the help of one of her two credit assistants, the loan officer had

created ghost loans from her first day on the job at Mujeres Unidas. Emboldened by her success, she steadily increased the number of fake loans till nearly one-third of an association (9 of 30) were ghost credits.

The corrupt loan officer was caught when one of her disgruntled credit assistants hinted to the Mujeres Unidas' financial officer that she should take a closer look at the operations of one of the branches. Upon checking a receipt from the loan officer's most recent loan disbursement, the financial officer noted many signatures with similar handwriting. When the financial officer went to the branch to ask for the original documentation, both the loan officer and credit assistant reacted nervously and tried to convince the officer that a verification visit to the suspect clients was unnecessary. The supervisor went on two visits and found two women who were registered as clients but who had never received a penny from Mujeres Unidas.

Esperanza fired the corrupt loan officer immediately, then appointed a trusted supervisor to manage branch's operations and document any additional irregularities. But the damage was far from over. Although the fraud involved fewer than 10% of the branch's clients, it seemed to have a poisoning effect on the branch as a whole. Many women, scared by the questioning of staff, wanted to return their loans and they were permitted to do so under the circumstances. Many remaining clients now lacked confidence in Mujeres Unidas. They lost the enthusiasm they once felt about being part of a special organization dedicated to helping them better their lives. Mujeres Unidas was not only losing fake clients, it was losing real ones as well – people who wanted nothing further to do with the organization.

History of the Organization

Mujeres Unidas gave out its first loans in April of 2002 in the state of Hidalgo, generally regarded as the third most economically marginalized state in Mexico. The target population of the organization was women who worked as street vendors, ran their own small home businesses and wanted to start a business. Nearly forty percent of first-time loan recipients did not yet have their own business. The majority of clients in business were engaged in some form of retail sales. Other clients were involved in food, personal services, or some form of manufacturing, producing goods such as clothes or traditional handicrafts. New clients reported earnings of approximately 20 U.S. dollars per week.

Mujeres Unidas opened three branches in its first two months of operations, and then opened another three branches three months later in August. It had the goal of opening twelve branches in the state of Hidalgo in its first year, then entering a new state of Mexico each subsequent year, eventually serving 100,000 clients. [Exhibit 1](#) shows the organization's growth goals.

But Mujeres Unidas had problems that she knew would seriously curtail the growth of operations:

Exhibit 1

Projections for the First 5 Years of Operations

	Number of Active Borrowers	Client Growth Rate	Gross Portfolio Outstanding
Year 1	2,760	0%	\$175,236
Year 2	6,000	117.4%	
Year 3	10,564	76.1%	
Year 4	15,207	44%	
Year 5	20,333	33.7%	

Challenges to Rapid Growth

The organization had 2,200 active borrowers after just seven months of operations, and that already exceeded projections for the size of loan portfolio and was just a few hundred clients short of its goal of 3,000 borrowers for the first year of operation. In its first months of operations, the organization had exceeded expectations for the number of clients and size of loan portfolio ([Exhibit 2](#)). But Esperanza worried how Mujeres Unidas would meet such optimistic projections in coming years.

• Internal Control Systems

Esperanza was aware that fraud was extremely common in young microfinance organizations, especially those with imperfect operations and information systems, but her experience with the troubled branch left her shocked by how much damage could be done by a single employee in such a short period time. She had known it was crucial for Mujeres Unidas to develop systematic internal controls, but she felt less pressure to do so when the organization had relatively few branches in close proximity. Mexico's micro-credit industry was nascent and the government would probably not establish regulations governing it for the next two years, let alone mandate controls such as reserve and audit requirements. Esperanza had budgeted for a full-time internal auditor in the second year of operations but with the discovery of the fraud, she felt she should add an internal auditor now, though the additional expense worried her.

Internal controls are the processes that reduce risk of employee theft and fraud during the credit cycle, and increase the possibility of fraud detection after the credit cycle. Some practices that reduce the risk of fraud include streamlining processes so that employees handle

less cash, modifying financial incentives to encourage employees to pay attention to the quality of their work and not just the quantity, and increasing the frequency and depth of supervisory visits.

- **Supervision**

Esperanza had planned to have one full-time field supervisor at each of her six branches. However, the first supervisor she hired quit one month ago because she was unhappy spending so much time traveling from branch to branch. Even before she quit, she preferred to stay in the central office revising loan documentation rather than monitoring problems at the branches.

Esperanza had hoped that weekly meetings with the loan officers and frequent visits to the branches by her and other staff would be enough supervision until she found a new field supervisor, but apparently this was not true. She had been looking hard for another qualified candidate to fill the field supervisor position, but it was always difficult filling vacancies at Mujeres Unidas.

- **Staffing Constraints**

All candidates for field supervisor that Esperanza met who had sufficient qualifications in terms of education and experience were not eager to travel to a small town two hours from Mexico City for work. Mujeres Unidas, as a start-up nonprofit organization, paid relatively low salaries while demanding long work hours. Esperanza was interested in promoting staff members to more responsible positions, but most were still fairly young and new. For many, Mujeres Unidas was their first job.

- **Geographic Dispersion**

As Mujeres Unidas grew at a rapid pace, new clients came to existing branches but increasingly they came to the newly opened branches much further away from the central office. The increased distances created new challenges for both supervision and information transfer. The majority of staff lived in the area surrounding the central office. Unfamiliarity with other areas and personal constraints prevented them from moving to the new regions where she hoped to open new branches. This meant that supervision at new branches would likely come from inexperienced personnel.

Expanding geographically also presented a problem for Mujeres Unidas in terms of client satisfaction. As nearby towns yielded fewer new clients, branch staff looked to recruit new borrowers from more remote areas. Ironically, these borrowers often paid more in transportation costs to travel to weekly meetings at the branches than they paid in interest on their loans. Preliminary evaluations of her client base showed that clients from more remote

communities were much more likely to drop out of Mujeres Unidas after one three-month loan cycle than clients from centrally located communities.

- **MIS**

Mujeres Unidas could barely manage its loan tracking system with its existing branches. Consolidating documentation on daily collections and new loan disbursements for processing by the systems department was difficult since the newest branches were now a one hour drive away from the central office. Mujeres Unidas currently paid a driver to pick up loan payment information at the end of each business day, while Esperanza's systems director worked to develop a clear, cost-effective way to manage information from geographically dispersed offices. Future expansion plans were to incorporate more efficient ways of collecting information – via e-mail, fax, or even smart cards, options which would require expensive investment in new equipment at the branches.

Capturing data at the central office also presented problems. The MIS system which contained all client and portfolio information for Mujeres Unidas had been extremely laborious to use, not to mention error-prone. It took up to seven minutes to enter data for each client. With 2,200 active borrowers, it had become difficult for the systems department to insure the accuracy and timeliness of data.

Esperanza and her systems director had been looking for a new computer system to help Mujeres Unidas better capture data on its thousands of clients. However, switching to a new system would be an extremely costly process. There would also be a difficult transition period when information gets transferred from the old system to the new. Such transitions leave an organization even more vulnerable to fraud, as reports come out with less frequency and staff members realize that it is now possible to commit misdeeds unnoticed.

Donor Pressure

Esperanza had thought seriously about lowering growth projections and delaying expansion plans, but that too would have serious ramifications. As a start-up micro-credit organization, Mujeres Unidas was highly dependent on donor funds. Many of the funds that helped sponsor Mujeres Unidas were given on the basis of specific growth projections of the number of clients and the size of loan portfolio. If Mujeres Unidas underperformed, Esperanza worried that she would not receive the same level of donations.

While Mujeres Unidas was strongly committed to sustainability (operating using income from loans rather than donations), she needed donations to fix many urgent problems plaguing her association, such as the antiquated

MIS and insufficient supervision, not to mention her goal of opening more branches. She saw that it took approximately one year for a branch to cover its costs, which included salaries of loan personnel, cost of funds and the costs of training borrowers in healthcare, business management and personal development at their regular meetings.

Questions for the Case

- (1) Should the director lower her growth expectations, keeping in mind that several large donations were based on these projections, and expend more resources on improving operations?
- (2) How should she go about solving her key resource problems, namely lack of staff and MIS?
- (3) Which internal controls should she incorporate to prevent employee fraud in her organization?
- (4) How can she restore the confidence of both her clients and her staff?
- (5) What should she say about her firm's current situation at her upcoming meetings in New York?

Exhibit 2

The First Months of Growth of a Start-up Micro-credit Organization

	April	May	June	July	August	September	October
Number of New Borrowers	53	102	283	220	440	550	588
Number of Borrowers	53	155	438	658	1,098	1,648	2,236
Loan Portfolio (US dollars)	\$6,500	\$17,437	\$40,669	\$51,497	\$89,794	\$154,589	\$175,095

ENDNOTES

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