

Staff Incentive Schemes – The International Experience

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There is little dispute among microfinance practitioners that well-designed staff incentive schemes can have positive and powerful effects on the productivity and efficiency of MFI operations. Nevertheless, despite the practical relevance of the topic, very little systematic research has been carried out to date. This is perhaps symptomatic for the whole topic of human resources in microfinance, which has by and large not been awarded much prominence in the microfinance literature. The *MicroSave*/ECI workshop in Pretoria is the first international conference of microfinance practitioners (and of a network) focusing exclusively on staff incentive systems.¹ This paper attempts to give a short (and necessarily selective) overview of the international experience with staff incentive schemes.

Staff Incentive Schemes Outside the Microfinance Industry

In many of the more “traditional” industries, monetary and non-monetary performance-related incentives for employees are a common element of compensation policies. To name just a few examples:

- Computer and software firms such as IBM have long used sales compensation plans that pay employees’ commissions based on individual performance.
- Procter and Gamble, now one of the largest consumer goods companies in the world, introduced a profit sharing plan for staff in 1887 (!)
- Sear’s Auto Centers (a division of Sears, Roebuck & Company) were forced to change their incentive compensation program in 1992, after there was an avalanche of customer complaints. Employee compensation had been based on the amount of repairs that customers authorised. It is not surprising that staff became adept at “detecting” problems so that in many cases unnecessary repairs were carried out.²

Also, the widespread use of special incentive schemes for senior management, especially in the form of stock option plans, has caused considerable (and often controversial) public debate. A few months before the (in)famous corporation Enron became bankrupt, one of its top managers cashed in on stock options worth US\$ 61 million that he had been awarded as part of a long-term executive compensation plan. Recently, it emerged that the former CEO of ABB, a huge power and engineering conglomerate, had received a retirement package worth € 100 m.³ The ensuing scandal forced him to return the “bounty” to his former employer. While such excesses (or horror stories) will force shareholders and directors of large corporations to scrutinize and possibly revise the bonus and benefits packages offered to their senior managements, there is no question that performance-related pay will remain an important element of the compensation strategies of most major firms and corporations.

Staff Incentive Schemes in MFIs

As was pointed out in the introduction, staff incentive schemes are still something of a “white spot” in microfinance. Most of the available data are anecdotal and limited to specific MFIs, and so far no systematic research has been conducted on this topic. The *MicroBanking Bulletin*, for instance, does not collect any systematic data regarding staff remuneration and incentive schemes. Apart from Marguerite Robinson’s contribution to the 1997 MicroFinance Network conference and Craig Churchill’s description of some staff incentive schemes as examples of success factors in individual lending not much has been written about the subject to date.⁴

¹ The 1997 Annual Conference of the MicroFinance Network in Alexandria, Egypt, included a session on staff issues in microfinance.

² Noe et al. (1997): 488

³ Financial Times, February 18, 2002

⁴ M.S. Robinson (1997): Staff: preliminary thoughts on how to retain good staff in MFIs. Paper presented at the MFNs 5th Annual Conference, held in Alexandria, Egypt.: <http://www.bellanet.org/partners/mfn/egypt/staff.html>, C.F. Churchill(1999): Client-Focused Lending. The Art of Individual Lending. Toronto and Washington, D.C.: Calmeadow. An early contribution to the topic was: C. Stearns (1993): Monetary Incentive Schemes for Staff. Bethesda, MD: GEMINI and USAID.

Among microfinance practitioners, however, the issue of appropriate incentive schemes for staff has occupied a not insignificant degree of prominence for a long time.⁵ Also, it seems that a recent debate in the *MicroBanking Bulletin* has somewhat renewed the industry's interest in the subject.⁶ In any case it is a promising sign that a network of the calibre of *MicroSave* is beginning to develop a toolkit for the development of staff incentive schemes.

Some Basic Industry Parameters

Microfinance has evolved as one of the most popular development and poverty reduction tools. Apart from such "pioneers" as BRI, BancoSol and Grameen Bank, there are countless microfinance organisations worldwide: the 1997 Microfinance Summit in Washington counted more than 1,000 MFIs with more than 1,000 clients each. While the industry is still dominated by NGOs, there has been an increasing trend towards formalisation. Recent data from the *MicroBanking Bulletin*, probably the most comprehensive compilation of industry data, highlight the fact that while some progress has been made in achieving the two main goals of microfinance, namely outreach and sustainability, a lot still remains to be done. Out of the 148 participants from 53 countries (who on average represent a rather strong subgroup of the total industry membership) 57 are financially self-sufficient. The average financial self-sufficiency ratio stood at 89.8%, and the average portfolio yield at 38.1%. Average expenses as a percentage of the loan portfolio amounted to 30.4% - a significant improvement when compared with the early 1990s, but still very high. An even more substantial improvement is denoted by the average portfolio at risk above 90 days of arrears of (only) 2.1%. Still, the average adjusted return on assets was -3.7%, a proof that there is still a long road to achieving full sustainability. In light of the strongly positive relationship between staff productivity and (financial) efficiency a closer study of the design and efficacy of staff incentive schemes appears more than appropriate.

The International Experience

Introduction

In the absence of any systematic research and empirical data on staff incentive schemes in microfinance, the following sections attempt to derive insights as well as some basic lessons from the study of a sample of MFIs that the author has been able to study and gather data on.⁷ Hopefully, the future will bring more complete compilations of such data. Nevertheless, the following case studies, which make extensive use of stylised facts, should help us to draw at least some tentative conclusions regarding the use of staff incentive schemes in MFIs. The following sections contain several empirical findings as well as a set of (preliminary) conclusions.

Empirical Finding # 1: Many Leading MFIs Utilise Staff Incentive Schemes

A cursory study of the microfinance industry suggests that many of the leading organisations utilise staff incentive schemes. To economise on space, this article draws on a selection of examples from Asia (BRI and Aceda Bank) and Latin America (Banco Ademi and several MFIs in Bolivia). Also, most of the *MicroSave* partner organisations (Action Research Partners) in East and South Africa have implemented some staff incentive scheme. Another noteworthy fact is that MFIs in Asia seem to use monetary staff incentives schemes to a smaller extent than their counterparts in Latin America, Africa, and Europe. Nevertheless, there is ample evidence that many (and probably the great majority) of the most productive organisations have employed staff incentive schemes.

Empirical Finding # 2: There Is a Wide Variety of Incentive Schemes in Use

If we research the issue beyond the mere fact whether an organisation uses any staff incentive scheme and inquire as to its exact nature, we will realise that there are many different systems in use. In fact, no two organisations use exactly the same scheme, even if they belong to an international or regional

⁵ As evidenced by the fact that the topic is included in Bob Christen's *Microfinance Handbook*: R. Christen (1997): *Banking Services for the Poor: Managing for Financial Success*. Washington, D.C.: Acción.

⁶ E. Bazobery: *We aren't selling vacuum cleaners: PRODEM's experiences with staff incentives*, and: M. Holtmann: *Designing financial incentives to increase loan officer productivity: Handle with care!*; both articles were published in the *MicroBanking Bulletin* 6 (2001); <http://www.microbanking-mbb.org>

⁷ This work is part of an ongoing research project by the author of this article at the Universities of Frankfurt and Trier, Germany.

network. In order to demonstrate the enormous variety of staff incentive schemes at the international level, the following short case studies present a number of short facts about some leading MFIs.

Bank Rakyat Indonesia (BRI) – Unit Desa System

- 4,007 Unit Desas (microfinance outlets)
- 2.65 million borrowers (all individual loans)
- More than 12 million depositors
- High degree of product standardisation
- Basic performance measure: unit profits
- New units given two years to break even
- Extremely decentralised structure (Head Office: 64 staff members, 4,000 units with more than 21,000 staff members)
- Main staff incentive scheme: profit sharing plan:
6% of unit profits are shared among unit staff (typically 4), up to 2.5 times monthly salary
- Also: Intensive Development Program:
Awards semi-annual cash prizes based on achievements
- Heavy emphasis on training

Acleda Bank, Cambodia

- 14 branches, 671 staff members
- 77,000 borrowers (mostly groups)
- Loan portfolio: US\$ 21 million
- 1,700 depositors (savings product only introduced recently)
- Staff incentive schemes:
 1. Annual Merit Pay
 2. Profit Center Bonus (if RoE>20%)
 3. Employees (400) hold approx. 6% of share capital
- Relatively high staff turnover, profit goal difficult to achieve for business units

Banco Ademi, Dominican Republic

- 27 branches, 240 staff
- 18,000 borrowers (individual loans)
- Loan portfolio: US\$ 55 million
- 16,227 depositors
- Staff incentive schemes:
 1. Performance-based monthly bonus for loan officers (staged scheme)
 2. Profit sharing: 10% of annual profits distributed to all employees
 3. Employee Stock Ownership Plan (ESOP): Staff hold 20% of share capital and have seat on Board of Directors
- Average RoE during last three years: >50%
- Staff turnover: almost nil.
- Good example of a very simple bonus system that appears to have performed remarkably well.

Illustration: Components of Bonus Formula at Banco Ademi

The monthly bonus for the loan officers is calculated on the basis of three variables:

1. Delinquency: Above a portfolio at risk of over 4%, loan officers do not earn any bonus on this variable. Starting at 4%, an ascending bonus is paid for each full percentage point less (i.e. <4%, <3%, etc.).
2. Number of outstanding loans: Starting at 130 outstanding loans, a bonus is paid. Again, this bonus is increased in stages as loan officers build up larger numbers of outstanding clients. The maximum bonus is reached at 151 clients and above.
3. Volume of outstanding portfolio: Similar to point 2 above, except that the monetary value of the outstanding portfolio is used to measure loan officer performance.

The bonus is added up every month and paid out in addition to the base salary.

The Bolivian Microfinance Industry, December 2001

- With Bangladesh, Bolivia (especially La Paz) is one of the most competitive microfinance markets
- The industry leaders are BacoSol, Caja Los Andes, FIE and Prodem, all of them highly productive
- Recent institutional data (December 2001) show impact of delinquency crisis

	# of loans	Loan Portf. (\$ m)	PAR > 30 days
BancoSol	61,338	81.1	12.67%
Los Andes	43,530	52.6	5.97%
FIE	23,173	27.5	7.12%
Prodem	22,534	33.6	4.51%
Source: Asofin			

- Staff incentive schemes: all of the leading Bolivian MFIs have staff incentive schemes
BancoSol: Monetary incentives for loan officers, plans for an ESOP
Caja Los Andes: Individual incentive scheme for loan officers and branch managers, profit sharing scheme for top management and regional managers
FIE: Individual incentive scheme for loan officers (was recently changed from quarterly to monthly payout)
Prodem: Reject short-term monetary incentives (bad experiences), opted for long-term incentives instead (see article by Eduardo Bazobery in MicroBanking Bulletin)

Partner Banks of IMI AG

- IMI is an investment company, funded by private and public shareholders (www.imi-ag.de)
- Currently, the company holds shares in approximately 20 MFIs
- Staff incentive schemes:
 1. All of the investee MFIs utilise performance-based bonus schemes for credit staff
 2. Some banks have developed schemes for other banking operations (deposits, money transfers, cashiers, desk officers)
 3. Some banks are experimenting with schemes for middle management, especially branch managers
 4. One bank has introduced a scheme for top managers

Empirical Finding # 3: The Introduction of an Incentive Scheme Can Have Dramatic Effects on Institutional Performance

Again we will make use of a set of short case studies to derive some stylised facts and a set of conclusions.

Example #1: WWB Cali, Colombia

- After introducing a performance-based bonus system for the loan officers, productivity improved significantly and now stands at the top of the industry (644 outstanding clients per loan officer, individual lending)⁸
- Simultaneously, other important changes were introduced (individual lending technology, regional zones for loan officers, new MIS)
- Effect of new staff incentive scheme is therefore impossible to isolate, but most likely very positive (based on interviews at the time of implementation of the scheme)

Example #2: Constanta Foundation, Georgia

- Group-based lending technology, approx. 10,00 clients (one of the larger lenders in the former CIS)
- Following worrying delinquency problem in 2000 (PAR reached 9%), introduced performance-related incentive scheme for field staff; heavy emphasis on portfolio quality.
- Result: dramatic reduction in overall delinquency, down to 1.5%
- Side effect: Salaries of excellent loan officers make it unattractive to apply for supervisor job!

⁸ T. Farrington (2000): Efficiency in Microfinance Institutions. In: MicroBanking Bulletin, 4 (February 2000), pp. 18-23

Example #3: Downscaling Commercial Banks in Russia and Kazakhstan

- EBRD-sponsored downscaling programs attempt to reach the target groups of small and micro enterprises in through a number of participating commercial banks
- Introduction of performance-related bonus pay in participating banks has had very positive effects on loan officer productivity (on average 30-50%)
- Important side-effect in downscaling: changes in loan officer remuneration may force bank to re-engineer the whole salary structure.

These cases are only a small subsample of all the many instances in which staff incentive schemes were introduced by an MFI in order to deal with a perceived problem or to improve staff performance. In interviews with managers of microfinance institutions the following objectives are commonly mentioned as reasons for introducing staff incentive schemes:

1. Reducing loan delinquency⁹
2. Enhancing productivity and efficiency
3. Improving outreach and ability to cover costs (profitability)
4. Attracting and retaining excellent staff

Summary of the International Experience

Given the dearth of systematic empirical data on the subject it would simply be inappropriate to give a definitive summary of “the” international experience. The usage of staff incentive schemes in microfinance is as varied and heterogeneous as are the organisations that provide microfinance services to their clients. Nevertheless, based on the available evidence and the research currently carried out by the author, we can make a number of preliminary conclusions:

Worldwide, many (but not all) of the leading and most productive MFIs use some form of staff incentive scheme. This notion does not, however, is not supported by the Asian context, where a much smaller percentage of MFIs employ some form of monetary incentive program. It seems that the majority of schemes in place were designed to enhance asset quality and staff productivity. Generally speaking, all of the leading and most productive MFIs have excellent and highly motivated staff, and there is some evidence that well-designed staff incentive schemes can be useful and powerful motivators. Finally, while there are many similarities between the staff incentive schemes that we encounter in practice, no two are the same. In other words: *while highly productive MFIs seem to be homogeneous in that they use a staff incentive scheme, these schemes themselves are extremely heterogeneous*. A lot of further research will be needed to produce more insights into this topic.

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⁹ Centenary Bank's first implementation of a loan officer incentive scheme was motivated by similar external pressures as the one at Constanta Foundation: The scheme was primarily designed to cut back delinquency, and indeed, PAR was reduced dramatically subsequent to its implementation (see case study on CERUDEB in this reader).