Imp-Act Consortium

Making microfinance work for the poor and excluded

# Staff incentives: *Integrating SPM into microfinance capacity building*

Guidance Note

## Introduction

**Capacity building materials related to staff incentives for microfinance institutions (MFIs) often focus on individual, monetary incentives of loan officers for financial performance.** To build a strong MFI, where all staff are dedicated to the mission, they should be incentivised through a mix of financial and social performance indicators, taking into account the institution's social mission.

This briefing emphasises the importance of integrating a social lens into staff incentive systems when building microfinance capacity. It begins with some key questions to consider when reviewing an MFI's staff incentive system. It then identifies some emerging practices that MFIs are finding helpful in ensuring that the staff incentive systems appropriately balance their social and financial performance objectives.

## Key questions

- What goals and behaviours does the current staff incentive scheme reward? What is the balance between financial and social goals?
- What are the interrelationships between these goals? Are there any conflicts between financial and social goals? For example, when high productivity levels are rewarded, does that have any negative effects on staff and/or clients?
- Could taking any of these goals to an extreme have a negative social or financial impact? If so, how can the incentive system be structured to mitigate that risk?
- What are the potential positive and negative outcomes of offering staff incentives for achieving each potential financial and social indicator?
- What weight should be given to each goal?
- Could incentives be used to engage non-lending staff more fully in the achievement of the institution's social mission?
- How might individual incentives undermine team spirit or staff loyalty?
- To what extent might group incentives facilitate 'free riders' (that is, staff who are not performing well)?
- How can the staff compensation plan be competitive with other MFIs' plans and also contribute to socially responsible behaviour?
- How can you incorporate a balanced staff performance incentive system in a broader human resources policy, including recruitment and retention strategies?

## Emerging practices

**MFIs that seek to balance social and financial performance are experimenting with different ways to create balanced staff incentive systems.** These are some of the successful emerging practices:

### Use a combination of individual and group performance incentives

Experience has shown that short-term individual staff incentives with quarterly or monthly bonus accruals and payouts can produce significant positive effects on loan officer productivity and loan portfolio quality. In general, individual incentives for loan officers should award the breadth, depth and quality of outreach.

Group incentives designed over a long-term period, with half-yearly or annual payouts, generate better team spirit, loyalty and staff retention. They also ensure that staff work in a collaborative manner and do not compromise social goals for personal financial benefit. These incentives can be given at the branch or institutional level – for instance, based on the extent to which clients graduate from group to individual loans or rise out of poverty. Group incentives can be motivating for all levels of staff, from back-office administrative staff to senior management.

**Box one** highlights how one MFI uses a combination of individual and team-based performance incentives to move its staff towards balanced social and financial performance management.

### Box one: Balancing Prizma's individual and group performance goals

In Bosnia and Herzegovina, Prizma's performance management system combines rewards for team-based and individual performance. The team bonus is calculated as a function of six performance measurement indicators, including breadth of outreach, client dropouts, staff productivity, administrative efficiency, write-offs, and depth of outreach. The additional monthly individual bonus for loan officers is calculated as a function of four performance measurement indicators, including portfolio at risk, number of disbursed loans, number of active clients, and the client dropout rate.

Both incentive schemes effectively support the organisation's balanced mission, which is to improve the wellbeing of large numbers of poor women and their families by providing long-term access to quality financial services. Staff understand Prizma's social orientation, and the good working environment motivates them to achieve the MFI's social and financial goals. The monthly bonus scheme for loan officers focuses on productivity and portfolio quality without significantly reshuffling Prizma's balance of social and financial goals.

### Do not underestimate the power of non-financial incentives

When discussing staff incentive systems, most MFIs think of monetary incentives, especially to motivate loan officers to expand their portfolios and maintain portfolio quality. However, evidence shows that non-monetary incentives can also have a powerful impact on individual and group performance. Public recognition of efforts and certifications of appreciation can be powerful motivators, as can recognising staff by sending them to training programmes on a priority basis. Group rewards, such as a party for the branch with the most positive client feedback, can also

| Table one: Non-financial incentives | | | |
|---|---|---|---|
| **Categories** | **Examples** | **Pros** | **Cons** |
| Professional development | Inclusion in branch manager training | Greatly appeals to some employees. Long-term benefits for institution | May incur costs for training. May lead to demand for promotions |
| Recognition | Field agent of the month | Greatly appeals to some employees. Opportunity to showcase ideal performance | Only one or a few can receive without diluting its perceived value. May not motivate some employees |
| Honorary title | "Senior" field agent | Greatly appeals to some employees | May not motivate some employees. May lead to demand for a higher salary. |
| Employee benefits | Health insurance | Has a strong, positive impact on staff retention | May not motivate in the long term |

be a fun way to reinforce social performance objectives. Stimulating healthy competition can also foster branch cooperation and teamwork. Providing employee benefits such as health insurance and paid leave can be powerful staff retention tools.

**Table one** sets out different types of non-financial incentives and describes some of their advantages and disadvantages (pros and cons). MFIs should make sure that these rewards are linked to the achievement of clearly defined social goals.

## Consider positive and negative effects of indicators to ensure the right balance

The old adage, 'be careful what you ask for', also applies to the design of microfinance incentive systems. MFIs have found that if performance incentives ask for an increased portfolio, then that is what they will get. However, unless this is balanced with quality portfolio objectives, it might be at the cost of bringing in bad clients! To balance out the negative effects of some financial objectives, and to keep the mission alive, MFIs need to include social performance objectives in the incentive system.

Just as an emphasis on financial performance indicators alone can result in negative social performance, an overemphasis on social performance indicators can put financial performance at risk. Below is a list of various social and financial performance indicators that many MFIs use, and the potential positive and negative impacts resulting from using them for performance incentives. In developing microfinance practitioners' capacity, technical assistance providers can use this list to guide participants through a participatory exercise to help them assess the potential unintended consequences of over-emphasising a particular indicator used to motivate staff. Such an exercise can demonstrate the complexity and inter-relatedness of various indicators, and reinforce the importance of carefully balancing social and financial performance objectives.

## Table two: Impact of incentives indicators

**Productivity:** *Loan portfolio, number of clients, number of new loans per period*
Intended outcome: *Growth of loan portfolio, expansion of target client base*

| | Social impact | Financial impact |
|---|---|---|
| **Positive impact** | Greater outreach to target clients | Helps MFI reach scale |
| **Negative impact** | Risk of client over-indebtedness. Poorly trained groups might have portfolio quality problems. Increased focus on new clients can lead to loss of existing clients. Increasing number of non-target clients | Growing portfolio too fast can result in portfolio quality problems if loans are given without proper client credit-worthiness analysis |

**Portfolio quality:** *Portfolio at risk (PAR) > 30 days, delinquencies > 90 days*
Intended outcome: *Maintaining high portfolio quality*

| | Social impact | Financial impact |
|---|---|---|
| **Positive impact** | Good clients are retained and hence clients do not have to pay higher interest rate to cross-subsidise bad clients | High portfolio quality reduces credit risk to the MFI and lowers the costs of loan losses or loan recovery efforts |
| **Negative impact** | Can lead to unethical collection practices. Can exclude target clients as loan officers focus more on better-off clients | Zero tolerance for loan losses can actually result in opportunity costs in terms of lost target clients |

**Client retention rate**
Intended outcome: *Encourages behaviour that supports client success*

| | Social impact | Financial impact |
|---|---|---|
| **Positive impact** | Encourages staff to understand and respond to client needs | Reduces cost associated with lost clients and recruiting new ones |
| **Negative impact** | Loan officer may force people to stay in groups and not graduate to individual lending | Can lead to retaining bad clients or even phantom client retention |

**Table two (cont'd): Impact of incentives indicators**

| | Social impact | Financial impact |
|---|---|---|
| Administrative efficiency ratio<br>Intended outcome: *Keep costs low, improve efficiency of operations* | | |
| **Positive impact** | With greater efficiency, MFIs can reach more target clients and reduce interest rates in the long run | Low costs facilitate financial competitiveness and attract investors |
| **Negative impact** | High efficiency can come at cost of overworked staff who might project a bad image of the MFI to clients | Extreme efficiency in the short term can result in negative consequences, such as client relations, group meetings and collections being disregarded |
| **Percentage of women (or other targets)**<br>Intended outcome: *Reaching target groups* | | |
| | **Social impact** | **Financial impact** |
| **Positive impact** | Increased outreach to women, who are known to be responsible clients | High repayment rates from women clients leads to stable, sustainable MFI. Donors and investors often seek high % of women for their own social metrics |
| **Negative impact** | Excluding other potential target clients can put pressure on women to take loans for male relatives, reducing transparency and increasing risk | Women generally take smaller loans, which is administratively more expensive |
| **Percentage of clients in rural areas**<br>Intended outcome: *Reaching target groups* | | |
| | **Social impact** | **Financial impact** |
| **Positive impact** | Reaching target clients who often do not have any formal access to finance and are at the mercy of local money- lenders | Rural clients are often disconnected from national-level downswings and hence offer portfolio diversification |
| **Negative impact** | Higher costs of serving rural clients (higher travel and transactions costs) are often passed on to urban clients | High operating costs because of difficulty in accessing remote areas. Security risk of travelling in rural areas with cash for disbursement or from collections (social risk to staff as well) |

**Table two (cont'd): Impact of incentives indicators**

| | Social impact | Financial impact |
|---|---|---|
| **Percentage below poverty line on entry**<br>Intended outcome: *Targeting the poorest* | | |
| **Positive impact** | Increased outreach to the poor | The poor are proven 'bankable clients'. Donors and socially responsible investors support MFIs with high % of poor clients |
| **Negative impact** | Client might not be credit-worthy, which will harm the client as well as the MFI | Poor clients take smaller loan sizes, thereby increasing operating costs |
| **Quality of service:** *Client satisfaction, number of complaints*<br>Intended outcome: *Improving service quality and increasing client retention* | | |
| | **Social impact** | **Financial impact** |
| **Positive impact** | Better-served clients tend to perform better, repay on time, and stay with the MFI | Positive impact on portfolio quality and retention leads to improved financial performance and clients build word-of-mouth business |
| **Negative impact** | Listening to clients whose profile is not in keeping with the majority of the clients can lead to mission drift | Higher operating costs and pressure on frontline staff time |

Emerging practice indicates that MFIs should stipulate minimum social performance targets before financial incentives will be given. So, for example, according to its mission and strategy, an MFI will ask for a certain level of social performance such as client satisfaction, percentage of women clients, percentage of poor clients, etc.

Once these minimum levels are met, the MFI can offer incentives based on financial indicators such as number of new clients or total portfolio size. MFIs can also include social indicators with financial indicators and calculate the amount of the incentive based on a balanced formula.

In designing incentive schemes, MFIs should consider the potential long-term as well as short-term consequences. Care must be taken to ensure that focusing too much on one indicator does not jeopardise the financial health of the institution and/or its clients.

## Apply social principles to designing and communicating about the incentive system

The following general principles are important to build effective incentive schemes.

**Transparency:** the system should be simple and staff should be able to easily understand the criteria used (which goals they are being incentivised to achieve), how performance is measured, and how rewards are calculated.

**Consistency and stability:** the rules of the system should be known to everyone, uniformly applied and not changed arbitrarily.

**Fairness:** targets must be perceived as fair and achievable by staff (who are trained and quipped accordingly). Better performance should lead to recognition, higher pay and promotion potential.

Incentives have to be adequate for the job function and hierarchy level of staff. For example, incentives should be calibrated differently to take into account rural vs urban conditions, loan officers with group loans vs individual loans, etc.

**Effectiveness:** staff should be able to achieve recognition and a financial reward by working harder to help the organisation achieve its financial and social goals; the incentives need to be significant enough to motivate staff and make a difference.

### Regularly review results and adjust system

As with any system, it is unlikely that the MFI will develop the ideal incentive system with its first design. Therefore, it is important to let staff know what period of performance the current incentive scheme will cover. After an initial pilot of between three and twelve months, the MFI should review and verify the results and compare them with its projections (or intended results). It should proactively identify any unintended consequences by interviewing staff and assessing the reasons behind unexpected performance results (whether positive or negative).

For example, **PRODEM** in Bolivia abandoned its monetary performance incentives for individual loan officers after management noticed increasing staff turnover and declining branch cohesion. When negative consequences are discovered, the MFI should consider making adjustments to its incentive systems, keeping in mind the potential additional consequences that might result from the change. Finally, the incentive system should reinforce the institution's strategic priorities and objectives, which evolve over time. Therefore, MFIs should adjust their incentive systems to make sure that they remain in line with those strategic priorities.

## Conclusion

This briefing has emphasised the importance of integrating social goals and financial goals when building microfinance capacity related to staff incentive systems. The balance of indicators used for incentive systems must be carefully weighed to ensure that the desired results are achieved and to minimise any unintended negative consequences. Nonetheless, incentives are crucial for an MFI's overall success and realisation of its social mission.

## References

Holtmann, M. and Grammling, M. (2008) *The Role of Staff Incentive Schemes in Balancing Social and Financial Goals: Evidence from Four MFIs*, www.mfnetwork.org/images/stories/workinggroups/staffincentives/sis_to_balance_social_and_financial_goals.pdf (accessed 10 November 2010)

—— (2008) *Designing Staff Incentive Schemes to Balance Social and Financial Goals*, www.mfnetwork.org/mfn-working-groups.html ( accessed 11 November 2010)

–– (2005) *A Toolkit for Designing and Implementing Staff Incentive Schemes*, MicroSave, www.mfnetwork.org/mfn-working-groups.html (accessed 10 November 2010)

McKim, A. and Hughart, M. (2005) *Staff Incentive Schemes in Practice: Findings from a Global Survey of Microfinance Institutions,* www.mfnetwork.org/mfn-working-groups.html (accessed 10 November 2010)

MicroLINKS (2008) *Speaker's Corner on Staff Incentives*, 15–17 April 2008, www.microlinks.org/ev_en.php?ID=22431_201&ID2=DO_COMMUNITY (accessed 10 November 2010)

## About this series

**This series of Guidance Notes emerges from a collaboration between the *Imp-Act* Consortium and key industry technical experts.** Recognising that the ongoing support to MFIs from funders and support organisations is critical to ensuring a balanced approach to performance management, this series aims to help them integrate the missing "social lens" into existing MFI training materials. The notes provide targeted guidance on critical issues, as well as details on further resources available.

## Development process

The *Integrating social performance management into mainstream capacity building* initiative, led by the *Imp-Act* Consortium, involves a three-part strategy:

**Linking SPM experts with experts in key technical areas:** Consortium members and associates join forces with industry experts to apply a social lens to key technical areas.

**Reviewing existing mainstream training materials:** Through online workshops between project partners, gaps in training currently provided to MFIs are identified and prioritised.

**Facilitating online knowledge sharing discussions:** Each technical area is addressed in a facilitated discussion on the **SPM Network** in order to add to the rich experience base of these Guidance Notes.

## *Imp-Act* Consortium: *Learn, connect, share*

A range of online resources are available to help you improve your SPM practice:

The **SPM Resource Centre** offers step-by-step guidance on integrating a social lens into MFI performance management systems, including an interactive SPM self-assessment tool. Head to: **www.spmresourcecentre.net**

The **SPM Network** connects individuals and organisations who are committed to managing and achieving social performance in microfinance. The Network is a virtual space for practitioners to share experiences and information, and debate new ideas in SPM. Join in today! **www.spmnetwork.net**

The ***SPM Practice Guide*** offers step-by-step guidance on integrating SPM into your MFI alongside real MFI case studies. Download today in English, French, Spanish or Arabic.

***Fulfilling the Promise*** is a new film by the *Imp-Act* Consortium that captures the SPM experience of two mission-driven MFIs, SEF (South Africa) and AMK (Cambodia). Short and long versions are available in English, French, Spanish and Arabic.

**Learn more about the *Imp-Act* Consortium** and its work by visiting **www.Imp-Act.org**.

Imp-Act Consortium
Making microfinance work for the poor and excluded