Staff Incentive Schemes in Practice: Findings from a Global Survey of Microfinance Institutions

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**The Consultative Group to Assist the Poor (CGAP)** is a consortium of 31 bilateral, multilateral, and private donor institutions working to build financial systems that serve the poor in developing countries. Headquartered in Washington, D.C, CGAP acts as a resource center for the microfinance industry, setting standards, developing operational tools, offering technical and advisory services, training, and information on best practices. CGAP also provides funding for innovative projects. Learn more at: www.cgap.org
1. Introduction

Microfinance practitioners have long realized the importance of appropriate products, policies, and incentives for clients. Proper incentives and mechanisms also need to be devised to ensure optimal performance of the employees of microfinance institutions (MFIs). Employees, credit officers in particular, can have a critical effect on the performance of an MFI, accounting for as much as half of an MFI’s costs (in the form of salaries) and almost all of the “output” (promotion, screening, processing, monitoring, and enforcement of loans). Furthermore, it is often difficult for managers to directly monitor credit officers because they can spend up to 75% of their time outside of the office. Both of these factors indicate a great need for effective employee incentive mechanisms.

Traditionally, MFIs have offered their credit officers fixed salary contracts with small non-monetary incentives for good performance such as periodic awards, training opportunities, and public recognition. However, over the past five to ten years, there seems to have been a noticeable shift towards adopting formal staff incentive schemes to motivate their employees. Generally, “staff incentive schemes” refer to a system of financial and/or non-financial awards utilized to reward employee performance. This shift has been accompanied by another trend towards “commercialization” of the microfinance industry, characterized by increased competition, a shift from donor assistance towards capital markets, and a greater focus on sustainability and profitability. Despite the importance of staff incentive schemes for MFIs, we know relatively little about the actual utilization and design of staff incentive policies.

This paper reports the primary findings of a large-scale research project on the utilization and design of staff incentive schemes among microfinance institutions. The basis of the analysis and findings are the responses of 147 MFIs to a recent in-depth international survey on staff incentive schemes. The aim of this paper is to provide microfinance practitioners with a better understanding of the use of staff incentive schemes, including their perceived effects and limitations. The specific questions addressed in this paper fall into three general categories:

- **Utilization:** Which MFIs use staff incentive schemes (SIS), when did they adopt their schemes, what resources do they utilize in designing their SIS, and what are the principal reasons for not using an SIS?
- **Design:** What are the most common types of SIS, what proportion of staff receive incentives and what is the average size of the incentive? Further, what are the most important indicators used to calculate the incentives, and to what extent are they offered for staff other than credit officers?
- **Perceptions:** What have been the major perceived positive and negative effects of SIS, and to what extent are MFIs satisfied with their current scheme? What are the perceived technical capabilities and unmet demand for training and research on best practices for the design, implementation, and monitoring of SIS?

This paper will explore each of these areas in turn.

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2. Methodology and Limitations of Data

Before presenting the data, it is important to explain the methodology and type of information collected by the survey in order to better understand what conclusions can and cannot be drawn from this research.

The survey utilized by this study included 43 questions on institutional characteristics, staff incentive schemes, and perceptions of staff incentive schemes. The questionnaire was developed by a team of microfinance experts, was translated into French, Spanish, and Russian, and was pre-tested on several institutions. The survey sample was derived from three main sources: an e-mail distribution list provided by the Consultative Group to Assist the Poor (CGAP), networks of MFIs, and the MIX Market website.

A total of 147 MFIs responded with almost complete surveys out of a sample size of approximately 850. Thus, the response rate was about 17%. These 147 MFIs have a total of almost 34,000 credit officers and more than 12 million borrowers.

It is impossible to determine how accurately this sample represents all MFIs. Even so, special care was taken to assess the validity, or bias of the sample, through two separate exercises/techniques. First, the sample was compared with a recent CGAP database that combined MFI data from several different sources. Second, the sample was contrasted with data from countries where there exists a very close approximation of all MFIs within those countries (i.e. countries with virtually complete networks of MFIs). Based upon these comparisons, the survey sample seems to under-represent MFIs in Asia relative to the other regions and tends to over-sample larger MFIs (in terms of number of clients or size of portfolio).

There is also a potential unobservable sample selection bias whereby the MFIs that responded to the survey were those that were most interested in staff incentive schemes. We can find some minor observable differences between MFIs in our sample and those who responded, but we cannot know whether our sample is biased in unobservable ways as well (i.e. greater interest in staff incentive schemes).

It is important to remember that all findings and conclusions of this study are not necessarily representative of all MFIs in the world. Most likely, the sample is more representative of a large and diverse collection of MFIs that tend to be larger in size, relatively less representative of Asian MFIs, and more interested in staff incentives schemes than all MFIs.

3. Summary Statistics of Survey Respondents

Table 1 presents summary statistics for the 147 MFIs that responded to the survey.

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2 Christen, Robert Peck, Veena Jayadeva and Richard Rosenberg. “Financial Institutions with a ‘Double Bottom Line’: Implications for the Future of Microfinance.” CGAP website. Occasional Paper No. 8, July 2004 (http://www.cgap.org/publications/industry_surveys.html). Note: we eliminated MFIs that had less than 1000 clients from the CGAP “universe.” Our study is most interested in drawing conclusions for MFIs that have at least 1000 clients.
Table 1: Summary Statistics of Survey Data

<table>
<thead>
<tr>
<th>Region (% of total sample)</th>
<th>Legal Status (% of total sample)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America / Caribbean</td>
<td>Bank</td>
</tr>
<tr>
<td>Eastern Europe and Central Asia</td>
<td>Rural bank</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>Non-bank financial institution</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>Cooperative / Credit Union</td>
</tr>
<tr>
<td>South Asia</td>
<td>Non-governmental organization</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>Other</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Institutional Size (median)</td>
<td>Credit Methodology (mean)</td>
</tr>
<tr>
<td>Number of borrowers</td>
<td>Individual loans</td>
</tr>
<tr>
<td>Portfolio size (US$)</td>
<td>Group (solidarity groups)</td>
</tr>
<tr>
<td>Number of savers (mandatory)</td>
<td>Group (community / village banks)</td>
</tr>
<tr>
<td>Number of savers (voluntary)</td>
<td></td>
</tr>
<tr>
<td>Savings deposits (US$)</td>
<td></td>
</tr>
<tr>
<td>Number of branches</td>
<td>Location of Operations (mean)</td>
</tr>
<tr>
<td>Number of savers (mandatory)</td>
<td>Capital city</td>
</tr>
<tr>
<td>Number of savers (voluntary)</td>
<td>Other urban areas</td>
</tr>
<tr>
<td>Number of credit officers</td>
<td>Rural areas</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Institutional Characteristics (mean)</td>
<td>Self-Sufficiency*</td>
</tr>
<tr>
<td>Age of MFI (years)</td>
<td>Revenues exceed expenditures</td>
</tr>
<tr>
<td>Number of credit officers</td>
<td>Revenues are equal to expenditures</td>
</tr>
<tr>
<td>Monthly base salary of credit officers (US$)</td>
<td>Revenues do not cover expenditures</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MFIs with an incentive scheme</th>
<th>Number of Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>72%</td>
<td>147</td>
</tr>
</tbody>
</table>

† Note - All data is self-reported by MFIs.

* Each MFI reported the proportion of their portfolio across types of loans and geographic areas. The statistics for “credit methodology” and “location of operations” represent averages across all institutions.

** Portfolio at Risk was defined by institutions for varying periods of days past due (i.e. 1 day, 30 days, 90 days). Surprisingly, the average PAR did not vary significantly across definitions of PAR (ranging between 3.9% and 4.3%).

In Table 1 above, we see that a high proportion (72%) of the respondents have a staff incentive scheme. MFIs from Latin American/Caribbean and non-governmental organizations (NGOs) represent the greatest proportion of respondents. The average institution has a loan portfolio of $2.5 million, a portfolio at risk (PAR) of 4%, and is likely to be fully self-sufficient. In addition, much of its portfolio is based in rural areas and lent through individual loans or solidarity groups, rather than community or village banks.

4. Utilization of Staff Incentive Schemes

Although staff incentive schemes for MFIs have received much attention in recent years, there remain a large number of MFIs that have not yet implemented an incentive scheme. This study examines both the historical patterns of adoption of SIS as well as patterns of current SIS utilization across regions, legal status, and age of MFI.

4.1 Past Trends in Adoption

There is an impression in the microfinance sector that the adoption of staff incentive schemes has been quite rapid over the past five to ten years. This study tests that hypothesis by looking at past trends in the adoption of staff incentive schemes at the global level. The results show that:
• The percentage of MFIs using a staff incentive scheme has increased more than tenfold between 1990 and 2003, growing from 6% to 63%.
• Furthermore, the majority of the increase happened in just three years, from 1999 to 2002, when the percent of MFIs using SIS doubled from 30% to 60%.
• MFIs are implementing staff incentive schemes more rapidly now than in any period before 2000.

One consistent theme throughout the historical analysis is the recent spike in the use of SIS. There are several possible reasons for this recent trend. One explanation could be the publication of literature on SIS in the late 1990s that had not been previously available. Another possibility is an increase in the popularity of microfinance courses (such as the Boulder Microfinance Training Program) that encourage and coach MFIs in the implementation of staff incentives schemes. Some experts believe the trend is directly related to the broader commercialization of the microfinance industry. Regardless of the cause, all types of MFIs have shown a dramatic increase in the utilization of staff incentive schemes.

4.2 What Types of MFIs are Using Staff Incentive Schemes?

Although the utilization of staff incentive schemes has generally increased in recent years, there are interesting differences in the types of MFIs that are using SIS.

The Eastern Europe and Central Asia region, where 91% of respondent MFIs use SIS, is the leader in the utilization of staff incentives (see Figure 1). Staff incentive schemes are least popular in Asia, where only 44% of survey respondents have one in place. One possible reason for this pattern are regional differences in cultural attitudes towards incentives. Another possible reason is that the microfinance industry in the LAC and ECA regions has become relatively more commercialized than it has in Africa and Asia.

An analysis by legal status of the MFI reveals that 91% of responding banks have a staff incentive scheme in place, while 67% of NGOs, and 46% of cooperatives and credit unions have one.

The data also reveals that institutions that are less profitable and those with higher portfolios at risk are less likely to have staff incentive schemes. For example, 80% of profitable MFIs have an SIS, while the proportion is 59% among MFIs that do not yet cover their operational expenses. However, from this dataset, it is not possible to distinguish whether staff incentive schemes are the cause of this greater profitability or whether more profitable institutions choose to adopt a SIS.

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Looking at types of MFIs, we also observe that smaller institutions are less likely to have incentive schemes. This could reflect the fact that designing staff incentives requires technical knowledge or resources which small institutions do not have (see section 4.4). Another possible explanation is that since staff loyalty and motivation are more difficult to develop informally in larger institutions, they have a greater need for systematic incentives. Surprisingly, the primary area of operation (urban vs. rural), credit methodology (individual or group lending), and age of MFI do not influence the pattern of utilization of SIS.

4.3 What Resources do MFIs Use When Designing a Staff Incentive Scheme?

When looking at the resources MFIs use when designing their SIS, we see that almost two-thirds of MFIs with a staff incentive scheme found other institutions to be a helpful resource (see Table 2). This highlights the role of networks (either formal or informal) in the dissemination of technical knowledge.

When asked about participation in the design of their staff incentive scheme, 77% of MFIs reported that branch managers were included while 64% said that credit officers participated. Considering that all MFIs with SIS have incentives for credit officers, it is somewhat surprising that 36% of MFIs designed their SIS without the participation of those affected by the scheme.

4.4 Why Don’t All MFIs Have a Staff Incentive Scheme?

Managers of MFIs who have implemented an SIS most likely made a decision based upon a belief that the benefits would outweigh the costs. The survey asked MFIs who have not adopted an SIS to identify the major reasons for not adopting a staff incentive scheme. The most common reason, cited by half of the institutions, is a lack of financial resources (see Table 3). Generally, the adoption of an incentive scheme requires financial resources both for the implementation of the scheme and to pay for the actual incentives (it is politically, and often legally, difficult to reduce fixed salaries to pay for the incentive compensation). However, the productivity and financial benefits of the SIS can not usually be expected immediately.

The percentage of MFIs reporting financial reasons for not adopting an SIS is higher among NGOs (67%) than among bank and non-bank financial institutions (38%). However, there does not seem to be a difference between these two types of MFIs when citing a lack of technical knowledge as a reason for not adopting.

<table>
<thead>
<tr>
<th>Table 2: Resources Used by MFIs in Designing SIS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource</td>
</tr>
<tr>
<td>Other Institutions</td>
</tr>
<tr>
<td>Published materials</td>
</tr>
<tr>
<td>Consultants</td>
</tr>
<tr>
<td>Online Resources</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 3: Reasons Cited for Not Adopting a Staff Incentive Scheme</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reason</td>
</tr>
<tr>
<td>Financial reasons</td>
</tr>
<tr>
<td>Lack of sufficient technical knowledge</td>
</tr>
<tr>
<td>Institution is too small</td>
</tr>
<tr>
<td>Employees are already sufficiently motivated</td>
</tr>
<tr>
<td>Fear of negative consequences</td>
</tr>
<tr>
<td>Against organizational culture</td>
</tr>
<tr>
<td>Legal reasons</td>
</tr>
</tbody>
</table>

4 When measured by number of borrowers, portfolio volume, number of branches, number of staff members, or number of staff members.
5. Design of Staff Incentive Schemes

Staff incentive schemes vary depending upon whether they reward individual or team productivity, the performance indicators utilized, and the nature of the reward.

5.1 Staff Incentive Schemes for Credit Officers

Results indicate that individual monetary schemes are the most popular type of staff incentive scheme: 83% of MFIs with an SIS in place had a monetary individual scheme (see Figure 2). It is also important to note that many MFIs had several different types of incentive schemes at the same time. Interestingly, there is relatively little variation in the type of staff incentive schemes used by bank and non-bank financial institutions compared to NGOs. However, there are considerable differences across regions as Figure 2 shows.

The most significant difference between the regions is the more common use of monetary team based, monetary branch based, and merit pay within Africa and Asia relative to other regions.

![Figure 2: Types of SIS in Use*](image)

*Percentages represent the proportion of MFIs reporting that they use each type of SIS.

The ECA region has the highest utilization of monetary individual schemes and is the least likely to utilize the monetary team or branch based schemes.

Relative frequencies of payouts among various types of schemes were also considered in the survey. Most monetary individual schemes (about 75%) pay their incentives monthly while most of the ESOP, profit sharing, gainsharing, and merit pay schemes are calculated and paid on an annual basis. About half of the team and branch based incentives were paid out monthly and about half were paid out on an annual basis.

Respondents were asked to attach a detailed description of their scheme. The most common scheme for credit officers was a weighted formula based upon three or more performance
indicators (39 of the 53 responses). The formulas varied from straight-forward to quite complicated. Most had a minimum cut-off that had to be met in order to become eligible for incentives and most also had benchmarks for additional incentives. Some schemes had caps on the incentive payments (i.e. limits to 20% or 50% of fixed salary) while others adjusted their incentives based upon qualitative assessments as well. While most MFIs had a uniform set of benchmarks for all credit officers, three of the MFIs adjusted their benchmarks by branch or location (i.e. lower benchmarks for credit officers of rural or new branches).

A small number of MFIs (5 of the 53) had extremely simple schemes, often with just one indicator and/or one cut-off (i.e. number of clients or repayment rate). The remaining scheme descriptions consisted of MFIs with a merit scheme (4 respondents) and MFIs with a profit sharing scheme (4 respondents).

**Box 1: Types of Staff Incentive Schemes**

There are many kinds of staff incentive schemes in use around the world. The following are some of the most common:

- **Individual monetary schemes**: Staff can receive a monetary reward at the end of determined periods based upon their individual performance.
- **Team based monetary schemes**: Team members regularly receive monetary rewards which are determined by the performance of the whole team.
- **Branch monetary based based**: Branch staff members can regularly receive monetary rewards, based upon the performance of the branch.
- **ESOPs (Employee Stock Ownership Programs)**: Employees’ compensation is tied to the share price of the organization. This is either through direct ownership in shares of the company, or indirectly, through another mechanism such as a trust fund that invests in the company.\(^5\)
- **Gainsharing**: Under gainsharing plans, employees are entitled to a certain bonus depending on improvements in the performance of the institution.
- **Profit sharing**: Employees receive a certain percentage of the annual (or semi-annual) profit. The profit pool allocated to the employees is then distributed equally between all staff members, or according to some form of allocation criteria (base salary, individual performance, etc.)
- **Monetary tournaments/competitions**: Based upon certain criteria, individuals or teams are ranked relative to each other and monetary rewards are given to staff who achieve the highest ranks.
- **Non-monetary tournaments/competitions**: Individuals or teams are ranked relative to each other and non-monetary rewards (e.g. publication of their names in newsletters) are given to staff members who achieve the highest ranks, based upon certain criteria.
- **Merit pay scheme**: Based upon scheduled performance appraisals, staff can increase their regular salary.

**5.2 How Big are Staff Incentive Payments?**

Among MFIs that have an SIS, the average fixed salary is $295 per month and the average variable salary among those that receive an incentive is $160 per month. However, only an average 72% of credit officers receive an incentive payment. The results show that the average “magnitude”\(^6\) of incentives is 28%; in other words, for every $100 of a credit officer’s total pay, $28 is in the form of incentives.

We find that on average, the magnitude of incentive is considerably higher in the Latin America and Caribbean region, and slightly higher in Eastern Europe and Central Asia, than among MFIs in Africa and in Asia. We also find that the magnitude of incentives is lower among MFIs that

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\(^6\) Where magnitude refers to (incentive payment) / (fixed salary + incentive payment)
have a greater portfolio in rural areas, but that it increases as an MFI gets older. There were no significant differences in the magnitude of incentives between bank and non-bank financial institutions and NGOs.

5.3 Indicators for Staff Incentive Schemes for Credit Officers

The most commonly used indicators (in order of popularity) are: portfolio at risk, value of outstanding portfolio, number of loan clients, growth in the number of loan clients, and growth in the value of outstanding portfolio.

There are some differences between the performance indicators utilized by bank and non-bank financial institutions and NGOs: 50% of NGOs utilize number of clients as a major indicator while only 37% of banks and non-bank financial institutions do. Also, NGOs tend to use value of outstanding portfolio as an indicator less than bank and non-bank financial institutions (44% vs. 56%). This might reflect a slight difference in priority of institutional objectives between the NGOs and bank and non-bank financial institutions. Finally, it is interesting to note that although qualitative measures, such as supervisors’ appraisals, were only rarely employed (9% overall), 38% of MFIs in Asia report using them.

<table>
<thead>
<tr>
<th>Box 2: A Staff Incentive Scheme with Weighted Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bonus</strong> = 40%(Bonus(\text{PAR})) + 25%(Bonus(<em>{\text{avg. portfolio}})) + 25%(Bonus(</em>{\text{loan approvals}})) + 10%(Bonus(_{\text{self-sustainability}}))</td>
</tr>
</tbody>
</table>

- **Portfolio-at-Risk** (PAR) is included as a measure of the ability of the credit officer to manage operational risks. A credit officer would receive the full 40% of the bonus for this indicator if his/her PAR was 0. The higher their PAR, the lower the incentive he/she receives.
- **Average Portfolio** is included as a measure of the credit officer’s medium- to long-term productivity. The higher the average outstanding portfolio, the closer the credit officer is to receiving the full 25% of the possible bonus for this indicator.
- **Number of loans approved** is a measure of short-term productivity in a given month.
- **Self-sustainability** measures the financial self-sustainability of the branch.

Notice that as with any weighted scheme, the sum of the weights is 100%, and that the weight reflects the relative importance of each indicator.

5.4 Staff Incentive Schemes are Used for Other Staff As Well

Staff incentive schemes can be used for staff other than credit officers. The results of the survey reveal that other employees are participating in staff incentive schemes, but with much less frequency than for credit officers. Almost half of the MFIs with SIS offered monetary incentives for branch managers and supervisors while only about one third offered monetary incentives for other branch staff (such tellers and receptionists). The most common mechanism was to offer the incentives for other staff as a percentage of the incentives earned by the loan officers in the branch.
6. Perceptions of Staff Incentive Schemes Among MFI s

An important focus of this research is the manner in which MFI s perceive the effectiveness of SIS and the main positive and negative effects. Questions were also asked of MFI managers concerning the institutional capacity to implement SIS and interest in further training or research on the topic.

6.1 How Effective are Staff Incentive Schemes?

There is a great deal of interest among practitioners as to whether staff incentive schemes succeed in improving motivation and productivity. There also exist concerns among many practitioners about potential negative effects of SIS. MFI s were asked to rate the effect of their staff incentive schemes on a variety of subjects.

Table 4 reports the perceived effects of SIS by the respondents. Readers should be cautioned that these are perceived effects (by MFI managers) and do not necessarily reflect actual effects.

The data in Table 4 is good news to practitioners: a majority of MFI s reported a perceived high or very high effect upon overall financial performance, portfolio size (number of clients and value of portfolio), portfolio at risk, and staff motivation. However, there was relatively little perceived effect on improving client satisfaction, staff turnover, and staff loyalty. It is also interesting to note that there were relatively few negative reports of diversion away from the target population or of reducing employees’ intrinsic motivation. Overall, MFI s seem to find that SIS do have a positive impact.

<table>
<thead>
<tr>
<th>Table 4: Perceived Effects of Staff Incentive Schemes</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Effect of your staff incentive scheme on:</th>
<th>Very high effect</th>
<th>High effect</th>
<th>Medium effect</th>
<th>Low effect</th>
<th>Very low effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall improvement in financial performance (benefits minus costs)</td>
<td>14%</td>
<td>51%</td>
<td>30%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Increased productivity of credit officers: more clients/ higher portfolio</td>
<td>27%</td>
<td>52%</td>
<td>19%</td>
<td>0%</td>
<td>2%</td>
</tr>
<tr>
<td>Increased productivity of credit officers: lower portfolio at risk</td>
<td>30%</td>
<td>38%</td>
<td>20%</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>Increased loyalty of staff</td>
<td>14%</td>
<td>34%</td>
<td>39%</td>
<td>9%</td>
<td>2%</td>
</tr>
<tr>
<td>Reduced staff turnover</td>
<td>9%</td>
<td>32%</td>
<td>29%</td>
<td>18%</td>
<td>3%</td>
</tr>
<tr>
<td>Improved client satisfaction</td>
<td>3%</td>
<td>34%</td>
<td>40%</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>Increase in staff motivation</td>
<td>18%</td>
<td>55%</td>
<td>18%</td>
<td>5%</td>
<td>0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Negative perceived effects</th>
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</thead>
</table>

| Reduced focus on target population | 2% | 9% | 25% | 33% | 17% |
| Reduction in intrinsic motivation | 0% | 14% | 34% | 27% | 12% |
6.2 What are the Negative Effects of Staff Incentive Schemes?

Despite a generally positive perception of the effects of SIS, several MFIs reported some negative effects of their SIS.

By design, staff incentives are meant to reward high performing employees. However, 13 MFIs reported that their SIS resulted in a decrease in motivation among the credit officers who do not qualify for incentives (because they did not meet the minimum performance criteria). Seven respondents also commented on tension arising between departments that had staff incentive schemes in place and those that did not. Some employees either became jealous of the opportunities afforded their coworkers by the SIS, or were upset that they were not rewarded for their contribution to the loan officer’s productivity.

Six MFIs hinted at the problem of mission creep in the form of a shift in the focus of credit officers towards wealthier clients or clients in less rural areas in order to increase their incentives. Another negative effect reported by 5 MFIs was an erosion in the quality of portfolio as credit officers responded to the incentives by offering larger loans or being less thorough in their evaluation of the loans. Some other frequently cited negative effects include: reduction in teamwork, SIS does not reward overachievement, loan officers have become more risk averse, decrease in intrinsic motivation, and high costs of operation. In most cases, these negative effects reflect technical deficiencies in the incentive scheme’s design and could be mitigated through adjustments such as: lowering minimum requirements, changing weights allocated to performance indicators, and better communication with staff about the SIS.

6.3 How satisfied are MFIs with their current Staff Incentive Scheme?

Respondents were asked to choose the category that best describes their satisfaction with their SIS. The breakdown of responses was as follows:

- 33% report that their SIS needs “considerable improvements.”
- 62% said that their SIS “could benefit from some minor changes.”
- 5% believe that their “SIS does not need to be changed.”

It is worth noting that staff incentive schemes should be dynamic and adjusted periodically to reflect changes in conditions and institutional priorities. Therefore, it should not be surprising that 62% of MFIs need minor changes. However, it is a little more worrisome that one third of MFI managers feel that their scheme could benefit from significant changes.

6.3 How Knowledgeable are MFIs about Implementing and Monitoring Staff Incentive Schemes?

Adopting and maintaining an effective staff incentive scheme can be a challenging and complex undertaking. When asked about the design and implementation of staff incentive schemes, 71% of respondent MFIs agreed that their institution has a satisfactory or superior level of technical knowledge. Interestingly, the region where staff incentive schemes are relatively more common, Latin America and the Caribbean, has the lowest level of confidence in this area, with only 51% of MFIs stating that they have a satisfactory or very satisfactory level of technical knowledge. This is compared with 73% in Asia, 85% in the ECA region, and 84% in Africa.
The survey also asked MFIs about their technical knowledge on the monitoring and evaluation of staff incentive schemes. About 64% of MFIs agree or strongly agree that their institution has a satisfactory level of knowledge in this area.

6.4 Is There Demand for Further Research and Training Among MFIs?

The results in the previous section indicate that about one third of institutions are not comfortable with their technical knowledge of staff incentive schemes. Respondents were asked about their willingness to invest further resources in training on staff incentive schemes and whether they would be interested in participating in further research in this area. Worldwide, about 85% of MFIs responded that they either agree or strongly agree that their institution would be interested in further training and research projects on staff incentive schemes (“at a reasonable cost”). This does not vary greatly between regions.

Among MFIs surveyed that do not have a staff incentive scheme, 83% are interested in further training, and 90% are interested in further research. While these rates are only slightly lower than those for MFIs that do have a staff incentive scheme in place, it is important to remember that these conclusions apply only to the MFIs that responded to the survey. It is quite possible that these high figures can be explained by a tendency among MFIs that are not interested in staff incentive schemes to ignore the survey.

Box 3: “Beat the Budget”

Capitec Bank in South Africa uses a creative team-based monetary staff incentive scheme to encourage its employees to work as a team. Every quarter, each branch tries to “beat the budget,” or make a certain profit. For every 1% over budget that the branch earns, all staff in the branch will receive the equivalent of about 15 US$. However, incentives will only be paid if the region as a whole also makes a certain profit in the quarter. The MFI provides an extra 115US$ incentive for the regional manager. The MFI also attaches restrictions on the value of arrears in order for a branch to qualify.

This is an example of a monetary team-based scheme that is designed to encourage team work and to provide incentives for all staff (not just credit officers). An advantage of the scheme is that it does not just have a single cut-off or a cap on the incentives: each 1% over budget is just as valuable to staff as the previous one. Thus, it encourages staff to continue working hard to improve profitability, no matter how well their branch is performing.

7. Key Findings

The responses from the institutional survey on staff incentives have succeeded in providing a better understanding of the state of the practice of staff incentive schemes. Some of the results confirmed already existing beliefs on the rapid adoption of staff incentive schemes or the predominance of individual monetary schemes. However, many of the results may come as a surprise to practitioners and industry analysts. Of all of the findings of the study, perhaps the **ten most important conclusions** are that:
1. Staff incentive schemes are a relatively new technology (only 6% of our sample had a SIS in 1990) that has been adopted very rapidly, particularly in the past 5 years (utilization doubled from 30% to 60% from 1999 to 2002).

2. Staff incentive schemes are more likely to be used by MFIs in the ECA and Latin American regions, by banks, by profitable MFIs, and by larger MFIs. On the other hand, the credit methodology (individual, solidarity group, community bank), area of operation (capital, urban, rural), and age of an institution do not seem to affect the decision to adopt an SIS.

3. “Lack of financial resources” and “lack of technical knowledge” of SIS are the primary reasons cited by respondents for not adopting a SIS.

4. Many MFIs utilize more than one SIS at the same time but by far the most popular type of scheme is the monetary individual scheme for credit officers (utilized by 83% of MFIs with a scheme). Most of these monetary individual schemes consist of a weighted formula based upon three or more performance indicators and are paid out on a monthly basis.

5. The magnitude of the incentives is quite strong: the average incentive payment represents a little more than one quarter of a credit officer’s fixed salary.

6. Most MFIs found that the staff incentive schemes had a high or very high positive effect on overall financial performance and the productivity of the credit officers in terms of both quantity (number of clients and value of portfolio) and quality (PAR) of portfolio.

7. MFIs reported relatively few negative effects of the incentive schemes, but the two most common negative effects were: a reduction in motivation among credit officers who do not qualify for incentives and a shift in focus towards wealthier clients and/or more urban areas.

8. MFI managers are not fully satisfied with their current SIS: one third of the respondents felt that their SIS needed “considerable improvements” while two thirds felt their SIS needed “minor improvements.” Only 5% of respondents with an SIS felt that their scheme did not need to be changed.

9. There is strong demand for further training and action research projects on staff incentive schemes: 85% of respondents expressed their willingness to invest resources for training or to participate in further research on SIS.

10. In general, differences in the design of staff incentive schemes between regions are greater than differences between banks and non-bank financial institutions and non-government organizations.

An important finding of this analysis is the support it lends to the idea that staff incentive schemes work. While much of the literature says that staff incentive schemes should improve the efficiency and profitability of an institution, most MFIs report that this is the reality as well. This conclusion is important because an effective staff incentive scheme can allow an MFI to provide better and less costly service for its clients. Our analysis seems to indicate powerful reasons why an MFI should consider this opportunity to improve productivity. As discussed above, these findings on the effects of SIS are based upon the perceived effects of the MFI managers.

It is interesting to note that the most frequently reported reason for not adopting a staff incentive scheme is “a lack of financial resources.” Managers of these MFIs probably feel that they can not afford the cost of adopting a staff incentive scheme. However, among the respondent MFIs that do have a staff incentive scheme, 95% perceived at least a medium effect on improved financial performance. The second most commonly reported reason for not adopting a staff incentive scheme was “a lack of technical knowledge.” It seems that both of these “barriers” to
adoption could be mitigated through training and technical assistance. In fact, 85% of respondents expressed their willingness to pay a fair price for training and for participating in action research projects on staff incentive schemes.

This study is the first quantitative analysis of the utilization and design of staff incentive schemes. The findings serve to illustrate the patterns of utilization of staff incentive schemes, the characteristics of the schemes in use, and the positive effects perceived by the MFI managers. Further research could provide more detailed knowledge of the financial and social impacts of staff incentive schemes based upon actual data from institutions and their clients. Another important topic for future research would be a comparison of the effectiveness of different types of staff incentive schemes. While there is much more to learn about the nature and effectiveness of staff incentive schemes, this study represents an important step in deepening our understanding of the practice of staff incentive schemes.

**Box 4: Thinking about Adopting or Improving your Staff Incentive Scheme?**

Staff incentive schemes can be a very powerful tool for an MFI, helping it to increase its efficiency and offer better services for its clients. However, a staff incentive scheme can be damaging to an institution when it is poorly designed. If you are interested in implementing an SIS or changing the one your institution already has, then it is important to follow some key steps. A good place to start is the “Toolkit for Designing and Implementing Staff Incentive Schemes,”7 available for free from the MicroSave website. Also, many MFIs look to other institutions when designing their scheme, as our survey indicates. Other worthwhile resources include regional forums, consultants, and local associations that can assist with capacity building.

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