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**Study on Staff Incentives
at Microfinance Institutions**

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1. Project Description

Microfinance Institutions (MFIs) balance competing goals: they seek to grow quickly, serving as many poor clients as possible, while maintaining very high repayment rates. This is often both time-consuming, and requires visiting clients in rural locations. Because loan officers may make decisions about large amounts of money, it is imperative to provide them with incentives that align their behavior with the mission of the organization. Many organizations pay officers commissions based on the number of clients, or amount of loans they generate, sometimes reduced if there are non-performing loans in a client's portfolio.

The goal of this project is to identify different incentive schemes and other compensation arrangements used by MFIs in India, and to understand how effective these schemes are. Particular attention is paid to staff incentives for client recruitment and retention, credit volume and the share of delinquent loans.

2. The Survey Instrument

For the purpose of this project we designed a survey questionnaire (see Appendix 1 and 2). In each MFI we interviewed one person from the Head Office (CEO or CFO) or other senior level management staff (HR Manager, Branch Manager, Operations Manager) familiar with the available incentive scheme. Our goal was to identify different incentive and compensation structures and how effective these are to achieve the desired goals. Also, we interviewed one or two Field Officers in an attempt to measure how responsive and motivated they are by the current incentive scheme in place.

3. The Sample

We ranked 27 Indian MFIs according to the number of active borrowers and we picked randomly 15 from the ranking list. Finally, due to time and operational constraints we managed to visit the following 12 MFIs: Spandana Sphoorty Innovative Financial Services, SKS, Basix, Micro Credit Foundation of India, KAS Foundation, Mahasemam Trust, League for Education and Development (LEAD), Indian Association for Savings and Credit (IASC), Pragathi Sewa Samithi (PSS), Payakaraopeta Women's Mutually Aided Co-operative Society (PVMACS), Swayamshree Micro Credit Services, Adhikar.

4. Findings

The following incentives are incentives found in the above mentioned Institutions as part of their overall incentive scheme. The most common ones are those which encourage the Field Officers to attract New Members or form New Groups (New Members/New Groups Incentive) and to make sure that their clients repay the monthly/weekly installments (Repayment Rate Incentive). We group the incentive payments we found in three main categories based on the different goals the MFIs seek to achieve: incentives to foster growth of client base and loan portfolio, to ensure portfolio quality and to reward and enhance employees' good performance.

4.1 Incentives

4.1.1 Incentives for Growth

Increase in Client Outreach

New Members/New Group Formation Incentive: Half of the MFIs we visited have an incentive for New Members or New Group Formation. The majority of those MFIs provide the incentive payment to the Field Officers. Only in one case the incentive payment goes to the Development Facilitator (one level up from the Field Officer). The incentive could be either for each new member (part of the group), for each new group formed or for each new individual loan client—if the MFI has individual lending products. The amount of the incentive payment varies from Rs1 to Rs12.5 per member and from Rs75 to Rs300 per group. In one MFI with individual lending product the incentive payment is Rs. 50 for each new individual loan client.

New Branch Incentive: One MFI has introduced this incentive in an attempt to achieve fast client outreach in new areas/districts of penetration. The target is based on the potential growth in the new area, which according to their estimations can be on average up to 3,000 loan clients. Therefore, the incentive is as follow: for the first 2,000 clients per branch each Field Officer will get Rs. 1,000 and for the rest 1000 clients he/she will get Rs. 500.

Loan Client Management Incentive: Client management includes: installment collection, the issuing of new loans, loan utilization checks and the relations you built with your clients. Client management focuses on the quality of services provided to the clients, which could enhance clients' commitment to the organization and foster sustainable growth of the client base. The incentives we found were as follow:

- » The Field Officer gets Rs. 5 for each client managed and
- » Rs. 10 for each individual loan client managed.

Replacement Incentive: In case of dropouts replacement is essential to ensure increase in the net client outreach. To promote this some MFIs provide additional payments (up to Rs. 25) to the Field Officers, who replace the clients that leave, while at the same time discourage dropouts by deducting an equivalent or higher amount.

Disincentive for Dropouts: 2 out of 12 MFIs that we visited have a penalty for dropouts. In both cases the Field Officer gets a penalty for each loan client that drops out, which varies from Rs. 5 to Rs. 50 depending on the MFI and the other incentive payments available.

Growth of Loan Portfolio

Loan Volume Incentive: To increase loans o/s MFIs provide incentives either on the number of loans or on the number of Rs. disbursed. In our sample we found two MFIs that provide Loan Volume Incentive; the first provides an incentive payment on the number of Loan applications: Rs. 400 for the first 3 loan applications and above that Rs. 100 for each extra loan application and the other on the amount of Rs. disbursed over the period of 2 months. However, in the second case the Loan Volume incentive is determined by both the amount of Rs. disbursed and the delinquency rate of the loans o/s. (see Graph 1 for details)

4.1.2 Incentives for Portfolio Quality

Repayment Rate/Recovery Amount Incentive: 4 out of the 12 MFIs have an incentive for Repayment Rates or on the Recovery Amount. In the first case the Field Officer gets an incentive payment if

his clients/groups have 100% Repayment Rate. In this study we came across two cases of Repayment Rate incentives:

- » Rs. 500/per month to the Field Officer, if the Repayment Rate of all his clients is 100%.
- » Rs. 20/per month for each group that has 100% Repayment Rate. Rs. 10/per month for each group that has less than 100% Repayment Rate

In the second case the Field Officer gets an incentive payment on the repayment amount. Providing an incentive payment on the recovery amount the MFI controls the quality of the portfolio and at the same time encourages the Field Officers to give larger loans; promotes therefore portfolio growth as well. Here we find, again, two different schemes:

- » Rs. 4/per client/per month if the Repayment Amount is up to Rs. 800 and increases by 1 Rs. for every additional Rs. 100 up to Rs. 1,000. Above the Rs. 1,000 the incentive payment is Rs. 7.
- » 2% on the Recovery Amount

Delinquency Rate/Portfolio at Risk Incentive: These incentives aim to reduce delinquent loans. 2 out of 12 MFIs have incentive payment to control delinquency rates.

- » Annual bonus, 2 months salary, to the Field Officer if all of his/her groups paid on-time or annual bonus, 1 month salary, if most of his/her groups (90%) paid on-time. In the latter case the Field Officer will get the bonus only if the delinquent payments are less than 30 days old.
- » The lower the delinquency rate, the higher the incentive payment. However, in this case the incentive amount is determined by both the delinquency rate and the amount of loans o/s. (see Graph 1 for details)

Branch Performance Incentives: Two MFIs extend portfolio quality incentives at the Branch Level, ensuring that Branch Managers support their teams to increase repayment rates, decrease delinquency loans and boost loan volume. The incentives found were as follow:

- » The Branch Manager gets 20% of his Field Officers' incentives. For example, if the Branch Manager has in his branch 3 (out of 6) Field Officers that get the Rs 500 incentive payment, he will get Rs. 300.
- » A cash award to the Branch Manager, whose branch, compared to all the other branches, has the best portfolio. Best portfolio is determined according to repayment rates and loan volume.
- » The Unit Manager gets an incentive payment based on the average incentives received by his Field Officers. In this case the Field Officer's incentives are determined by the amount of loans o/s and the delinquency rates.

4.1.3 Incentives to enhance Overall Good Performance

Field Officer's performance is determined by the above mentioned targets; the new clients he/she attracts or the loan applications he/she brings to the organization, the loan recovery, and on-time payments. Each MFI has its own priorities and according to those sets the criteria for the Field Officer's good performance.

Salary Increase: Field Officers' good performance is rewarded by the monthly increment on their salary attributed to the incentive payment. In most MFIs, where the Field Officer is paid a fixed salary there

is an annual increment according to his/her performance and/or seniority. The typical salary increase varies from 5-15%. In two MFIs we found that the Field Officer can receive a salary increase within 6 months from the day he/she joined the MFI depending on his/her performance. Among the 6 MFIs that have an incentive scheme in place, only two of them provide both fixed salary and incentive payments. In both of these cases, Field Officers get a salary increase based on their performance. In some other cases the salary is based on the number of groups the Field Officer maintains and varies accordingly. In these cases the Field Officer will not get salary increase unless he/she is promoted to a higher level position.

Non-Monetary Incentives: Most of the Institutions we include in our sample use non-monetary incentives to reward and enhance good performance. These incentives include promotion opportunities, achievement awards, staff development—through additional training programs—employment security, recognition of outstanding performance and other small presents. 75% of the MFIs we visited promote their Field Officers to higher level positions as recognition of their good performance and their commitment to the organization. 33% have achievement awards for the Best Field Officer and/or the Best Branch and 50% provide additional training to the employees with the best performance. In particular, additional training programs are common in MFIs with no incentive scheme in place and include training in financial management, delinquency management, client relations and retention, livelihood development etc. In some MFIs (25%), in the monthly meetings, the CEO or the Branch Manager praises the Field Officers for their good performance, while in other cases they offer a “free lunch for the whole branch”, a “family pick nick for the best performed Field Officers” or a small present as recognition of their outstanding work.

4.2 Incentive Schemes

In this study we found that the majority of the MFIs (6 out of 7) with an established incentive scheme in place combine growth objectives with control of portfolio quality. The following incentive structures indicate how MFIs use different incentives to align their growth strategy with the organization’s overall mission and the lending model used (e.g. Grameen, SHG, JLG, and/or Individual Lending)

4.2.1 Model 1: Aggressive Growth

4.2.1.1 *Increase Client Outreach*

This incentive structure is aligned with the objective of aggressive growth of the client base. All the available incentive payments aim to increase the number of active borrowers both at the group level and as individual loan clients. Incentives for loan client management and replacement of dropouts are there to ensure that net growth rate remains high. In addition to that, Field Officers in new branches are encouraged to expand fast in the new districts of penetration. This incentive scheme has been proved effective to achieve the fast growth objectives of the MFI, since according to the Business Development Manager’s statement: “Our client base has grown significantly!” However, control of portfolio and group quality is absent from this scheme and this might affect the MFIs long-term goals of client growth and financial self-sufficiency.

4.2.2 Model 2: Increase Client Outreach and Control Portfolio Quality

4.2.2.1 *Incentives for New Clients and 100% Repayment Rates*

This is a very basic incentive structure aligned with the objective of reaching more clients while ensuring repayment. Field Officers get an incentive payment for each new member or group they form and an additional bonus based on their installment collections. However, in this scheme there is no control over dropouts and maintenance of the client base. In addition to that, emphasis in client growth might result in poor group quality since screening, training and monitoring actions are of second priority. Field Officers driven by the incentive to attract new members might not put as much emphasis on borrower selection processes.

4.2.2.2 *Incentives for New Clients & Delinquency Rates*

This incentive scheme encourages growth in the number of active borrowers while controlling delinquency rates. The Field Officers get an extra payment for each new group they form, annual bonus if all or the majority of their loans were paid on time and a monthly payment for the groups they maintain. With the incentive payment on the Delinquency Rates the MFI controls delinquent loans less than 30 days, since the MFIs with this incentive structure call a loan delinquent a day after the payment is due. With this scheme the MFI controls both portfolio quality and client maintenance, while at the same time set targets for further expansion. However, in this case growth of loan portfolio might be slower and that due to the following reasons; first, because the Field Officers driven by the “new group incentive” might focus more on new client acquisition and second because the incentive on delinquency might make the Field Officer risk averse and prevents him to give larger loans.

4.2.3 Model 3: Increase Client Outreach, Portfolio Volume and Control Portfolio Quality

4.2.3.1 *Incentives for New Clients & Recovery Amount*

This incentive structure is aligned with the objective to increase client outreach while encouraging portfolio volume and repayment rates. First, the Field Officers are encouraged to ensure repayment, since they will have an increment in their salary by the incentive payment. At the same time, they are encouraged to give larger loans but without taking too much risk, since that will be reflected in their salaries. For example, the Field Officer will get Rs. 4 for every recovery amount less than Rs. 800, while he/she will get Rs. 5 for every recovery amount Rs. 800-900. Therefore, he/she might be willing to give a larger loan to increase his/her incentive payment but he/she has to be cautious with this decision. If the client is not able to repay this higher loan then he will not receive any incentive payment. Also, this incentive structure ensures a level of group quality control. Although, there is no particular incentive in place, the Field Officers should carefully select their borrowers and issue new loans according to their clients' ability to repay them.

4.2.3.2 *Incentive for New Loan Applications and Recovery Amount*

This is another incentive scheme that combines increase of client base and loans o/s with control of portfolio quality. The Field Officers get an incentive payment for every new loan application they bring and 2% commission on the recovery amount. The Field Officers have an interest to increase the loans o/s since higher recovery amount will be reflected as an increase in their salary. However, with this structure client outreach could be slower since the Field Officers can issue new loans to existing clients. In addition to that, ab-

sence of incentives for client maintenance might affect clientele growth even further especially in areas where competition with other MFIs is high. At the same time, the desired increase in the loan portfolio might be thwarted especially when the MFI operates in areas where the loan volume is low. That is due to the fact that the Field Officers might not feel as motivated by the incentive, when they cover for example rural areas with low loan volume since the incentive payment will not be high enough to compensate their efforts.

4.2.3.3 Incentives for Portfolio Volume, New Clients and Delinquency Rates

This incentive scheme promotes both client outreach and portfolio volume while encouraging reduction in delinquency rates. The Field Officers get their incentive payments based on both the loan amount outstanding and the delinquency rate. For example, according to Table 1, a Field Officer with total loans o/s of Rs. 15.1—20.0 Lakhs will get Rs. 100, if the delinquency rate is 5.1-7.0, Rs. 200 if it is 3.1-5 and Rs. 800 if it is less than 1%.

TABLE 1
Incentives paid to Field Officers based on bi-monthly delinquency rates

Loans O/S in Rs. Lakhs	Bi-monthly Delinquency range and Incentive Payable amount in Rs. by month			
	5.1-7.0	3.1-5.0	1.1-3.0	less than 1.0
up to 10.0	0	0	0	200
10.1-15.0	0	100	200	600
15.1-20.0	100	200	400	800
20.1-25.0	400	600	800	1,000
25.1-30.0	500	800	1,200	1,500
30.1-35.0	800	1,200	1,500	2,000
35.1-40.0	1,000	1,500	2,000	2,500
40.1-45.0	1,200	1,600	2,200	2,800
45.1-50.0	1,500	1,800	2,500	3,000
above 50.0	1,800	2,200	2,800	3,300

The incentive payment increases by a premium of Rs. 200—500 depending on the loan amount o/s and the delinquency rate; the higher the loans o/s and the lower the delinquency rate, the higher the premium from one bracket to the other (see Chart 1).

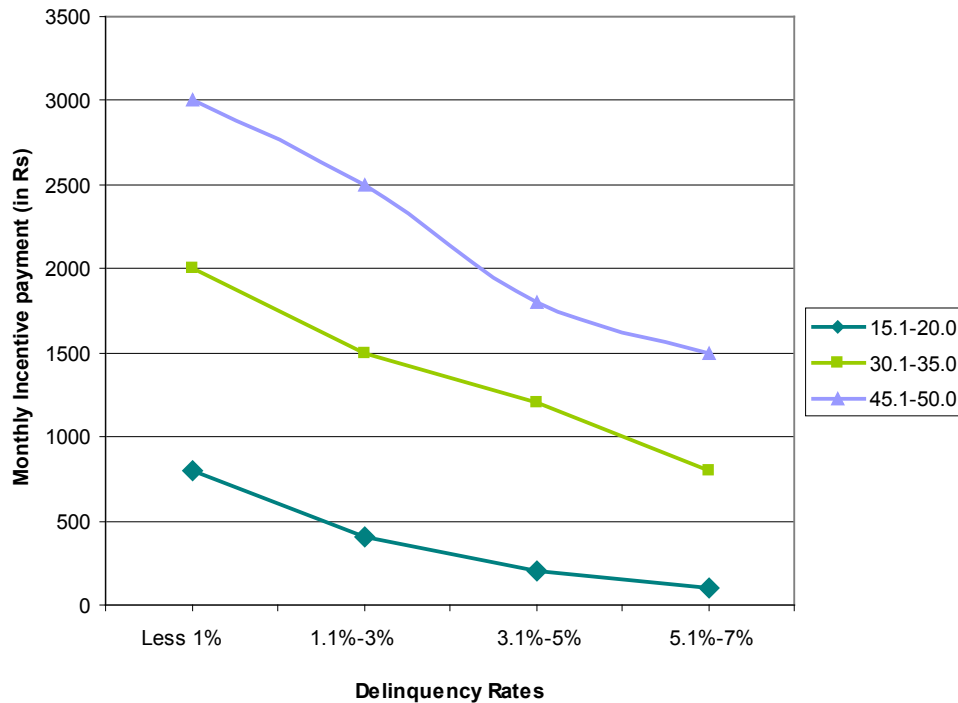
In addition to that, the Field Officer gets an incentive payment for each new individual client and an incentive for each new group he/she forms. This is an interesting scheme which controls portfolio quality while focusing both on client base expansion and portfolio volume. Also, the fact that it is a very structured scheme makes monitoring easier.

5. Conclusion

Through our research we can conclude that there is no one best incentive scheme. Incentive Schemes vary according to the goals and the targets of the MFI. The advantages and disadvantages of the above mentioned incentive structures should be taken into account by every MFI that wants to use this report as a point of reference for future revision and/or implementation of incentive based compensation arrangements. In addition to that MFIs should be aware of some common problems related to the incentive schemes that might

negatively affect the achievement of their goals.

CHART 1
Variation in the incentive payments according to loans o/s and bi-monthly delinquency rates



Monitoring: In order to make incentive schemes work MFIs need to have proper systems in place to monitor Field Officers performance towards the targets set by the Head Office. All the MFIs with an established incentive scheme in place report that they have systems to monitor Field Officers’ performance against these incentives. However, some of those without an incentive structure report that incentive schemes used in the past failed due to lack of proper monitoring systems.

Fraud: Incidents of fraud related to the incentives could be a result of either very high incentive payments or poor monitoring systems. Incentive payments should be neither too high nor too low, so they prevent fraud incidents while at the same time motivate the field staff. Evaluation of the monitoring capacity should always be taken into consideration in any reestablishment of the incentive structure.

Personal motivation: Incentive payments might reduce personal motivation and distort Field Officers’ performance. Driven only by the incentive payment, as the only way to increase his/her monthly salary, the Field Officer might focus on the specific target without caring for his overall good performance. Field Officers’ often report that they prefer being paid with a fixed salary, and not feeling the “pressure” of the incentive payment while taking decisions for their clients. A way to compensate this is through a combination of fixed salary and bonus based schemes, with emphasis on performance based incentives.

Myopia: Incentive schemes should be designed in that way to align short-term goals with long-term objectives. Sometimes MFIs driven by their mission towards poverty reduction try to grow fast and reach as many poor clients as possible without taking into account factors as group quality and/or portfolio quality. Incentive schemes designed with such a short-term orientation might eventually affect MFIs long-term sustainability and financial self-sufficiency.

