Rethinking Staff Incentives – An Experience from India

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The implementation of Staff incentive systems (SIS) has become an acceptable tool for many microfinance institutions (MFIs) and banks to boost employee productivity and to increase staff retention. Yet, one-size-does-not-fit all, and there is not a single SIS that fits all MFIs. Close attention must be paid to the question whether certain necessary preconditions (such as a functioning staff performance monitoring system) are in place before establishing a SIS and, even more importantly, the incentive system must be in line with the corporate culture of the institution.

This paper first outlines the concept of staff incentive systems on a general level before analyzing the case study of SEWA Bank, a cooperative bank in India Frankfurt School worked with through a greater capacity building project funded by KfW.

The story behind SIS in microfinance

Over the past ten years many papers and articles have been published on staff incentives in microfinance institutions worldwide, highlighting their promising and positive effects. The motivation for implementing such a system are in fact the same as in any other company or institution: to align the interest of the management (e.g. maximizing profit and/or outreach) with the interests of the employees (e.g. easier work, more spare time,) in an effort to avoid problems resulting from the information asymmetries that inherently prevail between those two groups. Closely monitoring each individual employee is mostly very time-consuming (and hence: costly) or even impossible. To overcome this asymmetric information problem, management can use both **monetary** and **non-monetary incentives** as a tool to motivate employees to give their best and work towards the institution's goals - rather than their own individual ones, which may not be directly in line with the institution's objectives.

Whereas non-monetary incentives exist in almost all MFIs in one way or another (e.g. election of the employee of the month, extra holidays, free work uniforms), monetary incentives so far exist only in a limited number of institutions. Introducing individual monetary incentives – paid on a short-term basis, e.g. after evaluation of the employee's monthly performance – indeed is a much more delicate issue[1], relying on complicated formulas and an accurate collection of employees' performance data. In addition, monetary incentives have not always proven successful: Numerous MFIs, who have taken the effort to develop a monthly bonus formula, declared recently that the introduction of short-term monetary staff incentives had failed in their institution, and that they wanted to move back to their previous remuneration scheme.

This mirrors Frankfurt School's experience with SEWA Bank, which shows just how challenging it is to plan the launch of such a system. Even once an institution does fulfil all required conditions (e.g. adequate IT system, performance indicators) the analysis' outcome may still be that introducing a monetary, short term staff incentive system is not the most suitable choice for an institution[2].

As our experience shows, it is in fact crucial to distinguish between socially- and commercially-oriented microfinance institutions. Whereas monetary incentives may have powerful positive effects in commercial MFIs, this paper shows that in institutions with a strong social focus and mission, in which idealism and corporate identity play an important role and greatly influence employment relations, monetary staff incentives are less adapted and have a great risk to fail.

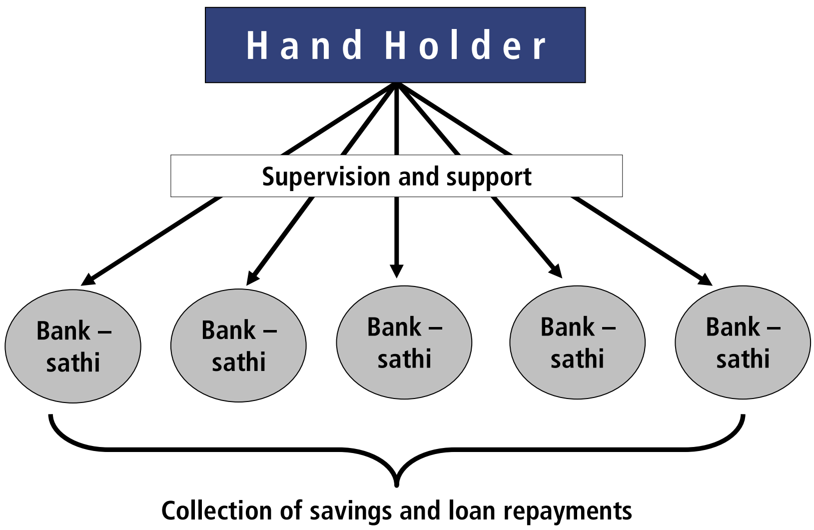
[1] Since most failures of SIS refer to monetary short-term incentives, we will focus on this aspect in this paper. Yearly or longer-term monetary incentives are of course yet another issue.
[2] The term "microfinance institution" is used in this paper in a general sense. It may refer to a non-banking / NGO MFI or to a banking institution operating in the field of microfinance (such as SEWA Bank).

Example SEWA Bank in India

India's SEWA Bank approached Frankfurt School in the context of a larger capacity building programme in 2008, and expressed interest in the introduction of a monetary staff incentive system. In fact, SEWA Bank had followed an impressive growth path during previous years, and the management realized that it became more and more difficult for them to monitor the performance of the increasing number of staff.[3]

Monitoring so far had been done manually through weekly or monthly meetings, during which employees presented their results, and targets for the upcoming period were discussed on a face-to-face basis. SEWA Bank thus wished to improve the individual performance measurement and to set incentives not only to further push the bank's portfolio growth by increasing the number of new clients; SEWA Bank also wished to improve the portfolio quality and to promote the doorstep banking approach[4] in its urban department. This way the bank hoped to improve individual performance and efficiency, thus contributing to an increase in the institution's overall productivity, outreach and impact.

In SEWA Bank's urban department, working solely in the city of Ahmedabad on an individual client basis, the so-called Banksathis and Handholders are mainly responsible for the credit business. Banksathis are the field workers in charge of collecting savings and loan repayments. Handholders are based in the head office and are responsible for supervision and support of Banksathis. The structure is shown in the chart below:



The Banksathis are actually not SEWA Bank staff. The management has chosen to employ them on a commission basis. They are hence paid 100% according to output and performance, and have no base salary. There are, however, two problems resulting from this: first, Banksathis are paid a percentage of the volume of loan repayments or deposits collected; they have hence a tendency to go after big amounts (neglecting the doorstep banking) and to focus on quantity, not quality. Secondly, with this commission payment some Banksathis have man-

[3] SEWA bank, established in 1974 in Ahmedabad, Gujarat, experienced enormous growth: within two years the number of active borrowers increased by almost 25% from 17,677 (2005) to 21,826 in 2007, when the KfW-funded project started. Being a regulated bank, SEWA Bank has the right to collect deposits (USD 18.9 million in 2008 for a total number of depositors of 318,594). Its gross loan portfolio was USD 8.65 million in 2008, for an average loan size of USD 400. Compared to the biggest Indian MFIs (e.g. SKS with 3.5 million active borrowers, followed by Spandana with 2.5 million active borrowers in 2008), SEWA Bank is relatively small. However, it has an outstanding reputation and plays a leading role in the microfinance sector in the state of Gujarat).

[4] The doorstep banking approach refers to small amounts that are collected on a daily basis from individual clients in urban Ahmedabad.

aged to earn in some months more than their supervisors (the so-called Handholders), who themselves are SEWA Bank staff.

In fact, being an institution with a long history, which has evolved from a women's movement towards a regulated banking institution, SEWA Bank staff today is still paid according to seniority and not based on job profiles, job responsibilities or performance in their work environment. Currently, the top management is sharing responsibilities with respect to human recourse related issues. There is no separate human resource department managing the currently 140 employees.

Non-monetary incentives

In order to better monitor and measure performance, SEWA Bank hence felt a need to standardize and structure the evaluation of their staff. The management decided to introduce incentives both on a short-term basis (directly linked to the monthly performance of staff, on a quantitative, objectively measurable basis) as well as on a long-term basis – focussing on qualitative performance aspects, related to work quality and ethics. Since the measurement of qualitative performance is subject to the impression and evaluation of (mostly) supervisors and cannot be measured objectively, it is recommended in general to include these aspects in annual appraisals – if at all.

Interviews with numerous employees furthermore showed that, next to monetary incentives, non-monetary incentives are highly appreciated by the women working for SEWA Bank (training, exposure trips, gifts like Saris, flowers, election of the employee of the month, etc).

Introducing monthly monetary incentives

As a first step, it was decided to apply the SIS on field staff and their supervisors only. The FS consultants started by addressing two issues, which were crucial for the development of the monetary incentive formula, which SEWA Bank wished to introduce:

1) The management information system (MIS) in 2008 provided insufficient information to calculate incentives. A review of the IT system was required to enable the IT department to yield all required information and install a functioning staff monitoring system.

2) Key performance indicators (KPI) needed to be defined for all relevant staff positions, in line with the overall strategic goals of SEWA Bank. However, it was noticed that the performance criteria highlighted by the management were not directly linked to the job descriptions of the employees. Job profiles were hence reviewed accordingly, and the importance was stressed to use these profiles from now on during the recruitment process.

In fact, SEWA Bank, as many other MFIs, very much relies on qualitative skills when selecting new staff. Trust, accuracy and friendliness are often more important than accounting skills, diplomas etc. In particular when it comes to field staff, interpersonal skills, reputation and trustworthiness are decisive – especially for a deposit-taking institution like SEWA Bank. In rural areas e.g. women are recruited from the very villages, where they are supposed to work – the educational background hereby is often only ranked second important.

During the consulting assignment, an incentive formula was hence developed according to the management's objectives, including quantitative, objectively measurable short-term indicators. Since the standardization of an incentive formula and the definition of concrete targets proved difficult, targets were defined as a percentage, looking at the relative increase in performance from one month to another.

Working conditions (for example travel distances) may vary greatly between staff and thus lead to great differences in performance, which are, however, not linked to the employee's effort. To avoid this problem and to define realistic targets, the management hence decided to look at relative performance increases – in line with the overall portfolio growth rate defined as target in SEWA Bank's strategic business plan.

After review of the MIS, the IT was able to produce performance reports, which could now be used to conduct costing exercises and, eventually, to run a pilot test phase. The management did not decide yet which maximum amount they wanted to spend on monthly incentives. Instead, realistic, maximum incentive payments were defined for each staff position. The costing exercise was supposed to reveal the sum of these expenses, which then should be weighed against expected benefits. The management did, for the time being, not wish to reduce the employees' base salary but –at least for the costing exercise- decided to pay the incentive on top of the current remuneration.

Interviews were conducted not only with the management but also with the concerned staff members to involve them in the process. SEWA Bank very much feared the suspicion of its staff. As generally recommended, transparency was hence a major aspect from the very beginning.

Even though the above-mentioned preparation to introduce a SIS was initiated slowly and with no rush, taking into account international best-practice and experience from other MFIs, the issue came up if it was not too early for SEWA Bank to introduce a short-term monetary SIS. Given SEWA Bank's strong social focus and current organizational structures, the question was raised if monthly incentive payments are actually in line with the bank's institutional culture.

The importance of institutional culture

Incentive systems usually serve one main goal: to improve productivity by increasing performance through motivation and loyalty among staff. Concerning the latter, however, it needs to be said that the loyalty of SEWA Bank's staff already *is* impressive. All of the interviewed women working for SEWA Bank emphasized that they highly appreciate SEWA Bank's services and are proud of being part of the institution. SEWA Bank's outstanding reputation in the State of Gujarat in fact also gives a certain social status and recognition to its employees.

SEWA Bank's employees (including field staff paid on a commission basis) very much identify with the corporate culture of SEWA Bank as well as its social mission, and they highly value the very good working atmosphere. Staff turnover is at very low levels; several women have indeed been working for SEWA Bank for more than 20 years.

Given this context, one can assume that the women working for SEWA Bank are already highly motivated and put a maximum effort into their work. This, on the other side, does not mean that productivity and efficiency may not be improved at SEWA Bank. However, it is questionable if the introduction of short-term monetary staff incentives would be the best way to do so.

Alternative ways to improve performance

For example, the creation of a human resource department – or at least a **human resource officer** – would help to centralize staff recruitment, monitoring, and evaluation and would help to standardize procedures. Qualitative aspects (such as trust) will always play a central role in the recruitment process at SEWA Bank. A human resource officer should however put emphasis on formal knowledge and qualifications, too. Once deficiencies are detected, SEWA Bank has at least the possibility to intervene by offering respective training measures.

Furthermore, since SEWA Bank's staff is not recruited primarily according to their formal education and prior professional experience, more intensive **staff training** would definitely have a great impact on the individual productivity and the output of the institution as a whole. Training would first and foremost address qualitative aspects of work. To improve client appraisal and screening procedures, e.g., would immediately reduce the number of non-performing loans.

Since SEWA women often work in the area where they live and know their clients very well, it often comes to situations of conflicting interests. *My friend xy asks me for a loan but I know that she won't be able to pay it back* – How should staff deal in such a situation? Training in realistic, day-to-day business situations has an immediate effect on the quality of work.

Further training in areas such as in marketing, customer relationship management, loan delinquency, accounting etc. would also have an important and immediate impact. Respective training curricula have already been developed for SEWA Bank's field and front office staff. These training should be systematically offered to new staff; existing staff may participate in advanced level or refresher courses on a regular basis.

The improved MIS will most probably reveal great differences in the performance of staff. These insights should be used to analyse the **division of work** as a whole. As indicated earlier, the different outputs yielded by employees are mostly not due to differing individual efforts, but working contexts. An analysis of the staff monitoring system will easily show which improvements can be made in this area to render the division of labour more efficient and fairer.

Next to these changes in recruitment, training and organization, it seems however inevitable to move towards a more systematic **performance measurement** of staff. One option is the introduction of a yearly performance review of staff (job responsibilities and targets set versus actual performance) or the introduction of a performance-based payment scheme. As a first step, the monthly base salaries should be set according to qualifications, skills and job responsibilities and, in a second step, remuneration or salary increases (or incentives for that matter) could be determined according to set performance indicators (measured monthly, quarterly or on a yearly basis).

This will be a difficult task of course – if not even an impossible one – since it would require a complete change in the current remuneration system and affect SEWA Banks' institutional culture. But it also bears opportunities since the younger and newly incoming staff would be employed and remunerated according to their qualifications. Hence, it may attract younger, well-educated staff members, who do not necessarily want to work for idealistic reasons only, but would be of great value to the organization.

Concluding remarks

For commercially-oriented MFIs, where portfolio growth stands above all and relationships between the management and employees are more anonymous, short-term staff incentives can certainly have powerful positive effects. In an institution with a history such as SEWA Bank's, having a strong social orientation and a staff force that works – for the time being – mainly out of idealistic reasons, the introduction of monetary short-term incentives (e.g. on a monthly basis) might yet create fear and distortions and even risks having adverse effects on intrinsic motivation (which has been SEWA Bank's key to success so far!).

Contrary to this, non-monetary incentives (training etc.) and alternative measures have an immediate, positive effect. At the same time, yearly appraisals – even if mainly focussing on qualitative aspects such as friendliness and respect of dress codes – get staff used to the idea of being monitored and evaluated. This performance measurement on an annual basis is a first step and easy way for management to better monitor and evaluate their staff.

It is to say that, if SEWA Bank continues on the same growth path as before and the relationships with and among employees – and thus its institutional culture – slowly change over time, the question of introducing monetary short-term incentives certainly will have to be reconsidered in the future.

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