

# Balanced Incentive for Frontline Staff: A Tool for Financial Institutions

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Keeping clients first  
in microfinance

## Version 1

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**Overview:** This tool considers staff incentive system design from one specific viewpoint—ensuring that clients are not harmed due to flawed staff incentives. The tool discusses the importance of balanced incentives, meaning incentives that balance financial performance (e.g., portfolio growth) with strong client protection practices (e.g., respectful treatment of clients). FIs can use this tool to improve their own incentive system for frontline staff.

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## Introduction<sup>1</sup>

Many financial institutions (FIs) choose to reward specific staff achievements as a way to encourage desirable outcomes such as portfolio growth and strong customer service. These FIs must make important decisions about which outcomes to incentivize, which indicators to use in staff evaluation, and how to assign weights to each indicator. This tool makes recommendations about how FIs can ensure that adequate client protection practices are taken into account in the design of staff incentive systems. Staff incentives should never unintentionally incentivize the mistreatment of clients by staff. The tool focuses on incentives for frontline staff (loan officers, sales people, etc.), as these staff have the most direct contact with clients and therefore, greater opportunity to harm or protect clients.

### Box 1.

#### The Smart Campaign Client Protection Principles

1. Appropriate Product Design and Delivery
2. Prevention of Over-indebtedness
3. Transparency
4. Responsible Pricing
5. Fair and Respectful Treatment of Clients
6. Privacy of Client Data
7. Mechanisms for Complaint Resolution

For more information, see [www.smartcampaign.org](http://www.smartcampaign.org)

### **FIs can use this tool to improve their own incentive system for frontline staff.**

The tool discusses the importance of balanced incentives, meaning incentives that balance financial performance (e.g., portfolio growth) with strong client protection practices (e.g., respectful treatment of clients). It presents three essential characteristics of all balanced incentive systems and discusses the negative consequences of unbalanced incentive systems. Finally, the tool describes several examples of balanced incentive systems used by financial institutions in different regions of the world.

## The Client Protection Standards Used in the Tool

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<sup>1</sup> This tool discusses incentive design from one particular perspective (client protection) and is not a comprehensive toolkit for designing staff incentives. For **additional guidance on designing staff incentive systems**, please refer to additional toolkits such as [A Toolkit for Designing and Implementing Staff Incentive Schemes \(Microsave\)](#), and [Designing Staff Incentive Schemes to Balance Social and Financial Goals \(MFN, CGAP\)](#).

FIs should be particularly aware of how an incentive scheme may affect client indebtedness levels and staff treatment of clients, as incentives can strongly influence practice in these two areas. As such, this tool is based on two Smart Campaign Client Protection Principles—Prevention of Client Over-indebtedness<sup>2</sup> and Fair and Respectful Treatment of Clients<sup>3</sup> (see **Box 1**).

The Smart Campaign has established adequate standards of care for FIs seeking to implement the Client Protection Principles. This tool lists the standards that apply to each discussion of the three essential characteristics of a balanced incentive system. These standards can be found in the Smart Campaign's [Getting Started Questionnaire](#) and are also used in the [Smart Campaign's Client Protection Certification](#).

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<sup>2</sup> Defined as (i) taking care in all phases of their credit process to determine that clients have the capacity to repay without becoming over-indebted, (ii) implementing and monitoring internal systems that support prevention of overindebtedness and (iii) fostering efforts to improve market level credit risk management.

<sup>3</sup> Defined as (i) treating their clients fairly and respectfully, (ii) not discriminating, and (iii) and ensuring adequate safeguards to detect and correct corruption as well as aggressive or abusive treatment by their staff and agents, particularly during the loan sales and debt collection processes.

## Characteristics of a Balanced Incentive Structure

**Characteristic 1: Incentives are offered as an addition to fair salaries and do not represent a high proportion of employees' compensation.**

**Client Protection Standards that apply:**

- The loan officer base pay is at least a living wage. (Indicator 5.4.6)
- The FI's productivity targets and incentive schemes are reasonable as compared to the industry benchmark (parameters and proportion of fixed/ variable remuneration). (Indicator 2.2.4)

Fair compensation is the foundation of any balanced incentive structure. Staff should receive a living wage as a base salary. This means that without any bonus pay, frontline staff can afford at least minimally satisfactory living conditions (food, shelter, clothing, etc.) in the location where s/he works.

Incentives such as bonus pay should never replace a living wage for staff, as under-compensation combined with high bonus pay may unintentionally incentivize fraud/theft, client mistreatment (e.g., bribing or overcharging clients), over-selling of products in order to reach performance targets, and other behavior that is harmful for clients.

For the same reasons, a FI's productivity targets and incentive schemes should be reasonable as compared to the local industry benchmark. In other words, it is important that staff members are not paid substantially less than staff of comparable institutions, and that the proportion of fixed/variable remuneration is also comparable.

Finally, it is important that the variable proportion of a field officer's salary be reasonable—not more than 50 percent, though 20 to 30% is often a better limit for avoiding undesirable staff behaviors. A reasonable limit helps prevent field officers from using poor practices such as aggressive sales or recovery tactics to meet their own basic salary needs.

**Characteristic 2: Incentives systems balance the value of portfolio quality with portfolio growth/size.**

Most incentive structures place a strong emphasis on productivity targets such as portfolio value and new loans/savings accounts/insurance policies per period. It is important, however, that the incentive structure places equal or greater weight

**Client Protection Standards that apply:**

- The FI's productivity targets and incentive systems value portfolio quality at least as highly as other factors, such as disbursement or client growth. (Indicator 2.2.3)
- If PAR is over 10% at the level of the MFI, bonuses are offered to loan officers able to decrease PAR below 10%. (Indicator 2.2.5)
- The FI does not endorse a policy of zero tolerance for PAR (Indicator 5.2.2)
- The FI does not use high pressure/ aggressive sales techniques. Does not force clients to sign contracts (for credit, no forced signing of any individual borrower or group member, or any guarantor). (Indicator 1.3.1)

on portfolio *quality*, in order to minimize the first risk presented in **Table 1**—frontline staff mis-selling or over-selling products. Staff incentives that encourage acquisition of new clients and growth in portfolio outstanding can encourage healthy growth for the FI, but when given too much value in the overall incentive system, such targets may prompt staff behaviors listed in the third column of **Table 1**.

At the same time, an incentive system that is unbalanced in favor of portfolio quality may create the second risk presented in **Table 1**—frontline staff mistreating clients. Though PAR is an important indicator of loan portfolio quality, incentive structures that over-emphasize PAR may promote overly aggressive collections practices such as threatening clients, publicly shaming clients, or premature confiscation of client collateral (see examples in the third column). Ensure that PAR is not the only portfolio quality indicator and do not use a policy of “zero tolerance” for delinquency, acknowledging that even very skilled field staff will encounter clients who cannot/ will not repay their loans.

**Table 1. Risk Factors of Unbalanced incentive Systems**

<b>Risk</b>	<b>Description</b>	<b>Example frontline staff behaviors</b>
1. Staff mis-selling or over-selling products	Pushing the client toward a product that does not fit his/her needs or approving a client for a product for which s/he should not qualify	<ul style="list-style-type: none"> <li>• Approving a loan for a client who already has loans with multiple FIs.</li> <li>• Selling an insurance policy that is too large for the client’s business size.</li> <li>• Pushing a client toward a savings account with a minimum savings balance that is too high for her to maintain.</li> <li>• Selling a client a loan with a reimbursement schedule that does not match her income stream.</li> </ul>
2. Staff mistreating clients	Interacting with clients in a disrespectful or harmful way	<ul style="list-style-type: none"> <li>• Charging a client unsanctioned, extra fees on products/services</li> <li>• Using aggressive collections practices such as threatening clients, publicly humiliating clients, or confiscating client assets prematurely.</li> <li>• Repaying a loans for a delinquent client in order to keep delinquency low, then charging the client a higher interest rate.</li> </ul>

Common portfolio quality indicators include portfolio at risk (PAR) and client delinquencies, but can also include less-traditional factors such as client retention, client satisfaction, percentage of clients who “graduate” from one product to another (e.g., from a group loan to an individual loan) or from one product level to the next (e.g., growth in client savings over time) (see **Table 2**). Such factors likely indicate keen attention to client progress on the part of the employee and encourage staff to view clients as a longer-term investment.

**Table 2. Indicators of portfolio quality for three products**

Credit	Savings	Microinsurance
<ul style="list-style-type: none"> <li>Portfolio at risk</li> <li>Loan renewal rate</li> <li>Client retention rate</li> <li>Delinquency rate</li> <li>Clients from the target group (e.g., women, low-income)</li> <li>Quantity/ quality of new client training delivery</li> <li>Client satisfaction with staff member (based on client feedback)</li> <li>Client movement from one product or level to the next</li> </ul>	<ul style="list-style-type: none"> <li>Client retention/ account renewal</li> <li>Client movement from one product or level to the next</li> <li>Clients from the target group (e.g., youth)</li> <li>Quantity/ quality of new client training delivery</li> </ul>	<ul style="list-style-type: none"> <li>Policy renewals<sup>4</sup></li> <li>Customer complaints<sup>5</sup></li> <li>Claims rejection<sup>6</sup></li> <li>Clients from the target group (e.g., rural, low-income)</li> <li>Quantity/ quality of new client training delivery</li> </ul>

**Box 2. Example of PAR as a portfolio quality indicator**

At [ASKI, Philippines](#), field officers may have up to 5% PAR in their portfolios before losing any portion of their bonus. This allowance for PAR was chosen based on market conditions, and the institution’s understanding that unrealistic PAR targets put undue pressure on field officers that may lead to client harassment.

When a field officer reaches PAR greater than 5%, s/he is then subject to a decrease in his/her bonus—called a “disincentive.” The “disincentive table” below shows how different PAR levels trigger decreases in the field officer’s bonus.

PAR	Disincentive %
0 - 5 %	0%
>5 – 6%	25%
>6 – 7%	50%
>7 – 8%	75%
>8 – 9%	100%
>9%	100%

Incentives based on longer time-periods (quarterly, semi-annual) may encourage staff to view client relationships as long-term “investments,” thus promoting

<sup>4</sup> Number of renewals / Number of potential renewals

<sup>5</sup> Number of complaints registered / Total number of clients

<sup>6</sup> Number of claims rejected / Number of claims in the sample

prudent product sales, appropriate client selection, and fair and ethical treatment of clients. Group incentives (as opposed to individual incentives) may also promote staff loyalty, team building, and staff retention, each of which may have positive effects on how staff approach their relationship with clients.

Finally, when choosing portfolio quality indicators, consider the institution’s social and financial goals, as well as your institution’s internal capacity to manage the indicators. This includes the capacity of:

- Staff (managers and field staff) to understand, explain, and use the incentive system
- Managers to measure and evaluate staff on the indicators
- The institution’s management information system to generate accurate and timely information on staff performance

**Box 3. Example incentive structure that balances portfolio growth/size and quality**

The table below provides a simple example of an incentive system that balances portfolio growth/size with quality and is modeled on the indicators used by [COOPAC Microfinanzas Prisma, Peru](#).

Objective	Indicator	Weight
Increase loan officer productivity	Number of new groups formed during the period	25%
	Total number of active borrowers during the period	10%
	Active loan portfolio size	15%
	Total weight for this objective= 50%	
Maintain high portfolio quality	PAR30 (%)	25%
	Total weight for this objective= 25%	
Ensure high-quality and participative education sessions for clients	% of education sessions facilitated (calculated as “education sessions facilitated/ education sessions scheduled”)	15%
	Average client attendance at all education sessions held during the period (based on client attendance sign-in records)	10%
	Total weight for this objective= 25%	

#### **Box 4. Example of integrating customer service indicators into an incentive system**

Due to financial constraints related to India's microfinance crisis, Ujjivan Financial Services Ltd. was forced to scale back incentive pay for staff in order to avoid staff layoffs. However, the FI still uses awards to motivate Customer Relationship Staff (CSRs)—the term Ujjivan uses for loan officers. The incentive system relies on a balance of portfolio quality and quantity indicators and requires that managers carefully evaluate the performance of branch staff.

CSRs are scored using a scale of 0 (poor performance) to 5 (excellent performance) on five assessment parameters:

1. Number of borrowers
2. % of idle customers > 60 days
3. Portfolio balance outstanding
4. Client repayment rate
5. "Customer connect"

Ujjivan's "customer connect" parameter is an assessment of how well the CSR performs the following duties:

- Organizing and leading the branch's social development programs (including health outreach programs, education activities and other social programs)
- Identifying customers who are in immediate need of additional support services from the FI
- Participating in meetings for client leaders ("center leaders")
- Developing positive relationships with customers and delivering excellent customer service

The customer connect requirement is the only subjective indicator in the incentive system, and as such, requires time and effort on the part of branch management. However, it is also an indicator that motivates strong client protection practices on the part of loan officers, and has a positive effect on branch culture.

**Characteristic 3: Incentives are periodically reviewed for their effects on clients.**

**Client Protection Standards that apply:**

- The FI managers and supervisors review ethical behavior, professional conduct and the quality of interaction with customers as part of staff performance evaluations. (Indicator 5.4.1)
- There is sufficient monitoring of the practices (by operations department, internal audits), to provide education or sanctions as necessary. (Indicator 5.4.4)

Well-designed staff incentive systems are still limited in their ability to influence positive staff achievements and behaviors. Even when an incentive system is used in conjunction with fair base salaries (see characteristic 1) and balances portfolio quality and growth/size (see characteristic 2), it requires careful monitoring by the institution to ensure that it does not create unintended negative consequences for clients, or that other negative consequences that would require adjustments to the incentive system are occurring.

Given the complex nature of designing an incentive system, most FIs choose to pilot a new system and make adjustments over time. Market or institutional changes such as high growth, staff turnover, or market saturation introduce additional complexity to the task of maintaining balanced incentives. Regardless of whether the institution has an existing system or is piloting a new system, it is vital that the FI periodically review the incentive system for its effects on clients.

This task should fall to senior management and internal audit/ risk management. These staff should examine a new system after three-to-six months and then annually thereafter. The role of internal audit is to monitor the factors presented in **Table 3** and report to management. Senior management should use this information, in addition to market information, to ask the essential questions presented in **Table 4**. The ultimate goal is to ensure that the incentive system is not creating unintended negative consequences for clients

**Table 3. Factors for Internal Audit to Examine**

<b>Factor</b>	<b>Sources</b>
Staff treatment of clients	<ul style="list-style-type: none"><li>• Client complaints data from the complaints system and client exit surveys</li></ul>

	<ul style="list-style-type: none"> <li>• Staff disciplinary reports/ data on sanctions applied to staff from Human Resources</li> <li>• Client feedback on staff behavior, including: <ul style="list-style-type: none"> <li>○ Respect toward clients</li> <li>○ Ability/willingness to explain products and answer questions</li> <li>○ Delinquency handling procedures</li> <li>○ Ability/willingness to resolve client problems</li> <li>○ Treatment during sales (e.g., pressuring clients)</li> <li>○ Quality of training provided to clients</li> </ul> </li> <li>• Peer feedback on staff behavior, including: <ul style="list-style-type: none"> <li>○ Conduct toward clients (see above)</li> <li>○ Adherence to staff rules and Code of Conduct including instances of violations</li> </ul> </li> </ul>
Staff training	<ul style="list-style-type: none"> <li>• Review of topics covered in recent trainings/ routine training (e.g., orientation)</li> <li>• Checks on staff knowledge of the Code of Conduct, client rights, sanctions for client mistreatment</li> </ul>
Portfolio / Sales	<ul style="list-style-type: none"> <li>• Growth patterns (locations; changes in trends; unusual cases; comparison with targets)</li> <li>• Spot checks of randomly selected staff portfolios (proper selection; proper loan decisions; check for ghost clients)</li> </ul>

**Table 4. Essential Questions for Managers to Answer**

<b>Question</b>	<b>Information to Consult</b>
Do incentives contribute to staff mis-selling or over-selling products?	<ul style="list-style-type: none"> <li>• Growth targets</li> <li>• Data on client multiple-borrowing and over-indebtedness</li> <li>• Information from internal audit on staff treatment of clients (see Table 3), particularly: <ul style="list-style-type: none"> <li>○ Ability/willingness to explain products and answer questions</li> <li>○ Treatment during sales (e.g., pressuring clients)</li> <li>○ Quality of training provided to clients</li> </ul> </li> </ul>
Do incentives contribute to staff mistreating clients?	<ul style="list-style-type: none"> <li>• Growth targets</li> <li>• PAR targets</li> <li>• Retention targets</li> <li>• Actual performance, compared to above targets</li> <li>• Information from internal audit on staff treatment of clients (see Table 3), particularly: <ul style="list-style-type: none"> <li>○ Respect toward clients</li> </ul> </li> </ul>

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	<ul style="list-style-type: none"> <li>○ Ability/willingness to explain products and answer questions</li> <li>○ Delinquency handling procedures</li> <li>○ Ability/willingness to resolve client problems</li> </ul>
Are incentives appropriate to market conditions?	<ul style="list-style-type: none"> <li>• Growth targets for staff</li> <li>• PAR targets for staff</li> <li>• Market conditions, including:               <ul style="list-style-type: none"> <li>○ Growth and saturation, by location</li> <li>○ Factors affecting client ability to repay (e.g. weather conditions in a region)</li> </ul> </li> </ul>
Do incentives impact service quality?	<ul style="list-style-type: none"> <li>• Staff workload/ caseload (e.g., clients per loan officer)</li> <li>• Sales targets (e.g., number of insurance policies sold in a period)</li> <li>• Client feedback/ complaints on customer service</li> <li>• Client questions about products/ misunderstanding of products (reflecting possible poor quality of understanding/explanation on the part of staff)</li> </ul>

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Using the information above, management should carefully evaluate the effects of the incentive system on clients, and make necessary adjustments to the system. Of the factors listed in **Table 4**, the institution’s targets for growth, staff workload, and PAR typically form the foundation of the incentive system and have the strongest influence staff behavior. More than other factors, the institution has control over these targets and should take great care to set targets that are realistic based on market conditions, client demand, and staff capacity.

As an example of how management should base targets on market conditions, frontline staff working in areas of the country with high penetration rates should have lower growth targets as staff in less saturated areas, to discourage client over-indebtedness. As another example, PAR targets should be adjusted if local conditions such as a natural disaster or political upheaval create repayment issues for clients.

Careful management of essential targets such as growth and PAR, and periodic reviews of the staff incentive system will take pressure off the institution to design a “perfect” system, and will instead acknowledge that any system has limitations that must be monitored in order to prevent risks such as client mistreatment.

### Box 5. MicroLoan Foundation, Malawi manages the client protection risks associated with staff incentives

In recent years, [MicroLoan Foundation](#) has pushed staff toward higher financial performance targets, using incentives in the form of quarterly bonus payments. Acknowledging the potential for such targets to create negative staff behavior, the FI also created a risk management tool for monitoring loan portfolio growth and quality alongside staff behavior toward clients.

The table below lists the portfolio indicators and the client protection indicators used in the tracking tool. **Please note** that this is not a list of the indicators used to incentivize staff, but a list of the indicators used to *monitor the effects of the incentive system* on client protection practices among field staff.

Portfolio Indicators	<ul style="list-style-type: none"> <li>• Average loan size</li> <li>• PAR</li> <li>• Caseload (number of clients per loan officer)</li> </ul>
Client Protection Indicators	<ul style="list-style-type: none"> <li>• Negative repayment coping strategies (e.g., selling assets to pay a loan)</li> <li>• Multiple loans</li> <li>• Harsh collections practices</li> <li>• Loan officer attendance and timeliness at meetings</li> <li>• Quality of client training delivered by loan officer</li> </ul>

The tool allows management to monitor whether financial targets affect how staff treat clients, potential client over-indebtedness, and the quality of service delivery. To do this, each of the three portfolio indicators is analyzed next to one or more of the client protection indicators. For example, the tool analyzes average loan size alongside negative repayment coping strategies, to determine whether incentives for portfolio growth (average loan size) may be encouraging officers to make loans that clients have difficulty repaying. The tool also measures caseload against loan officer attendance and timeliness at meetings in order to monitor whether service quality deteriorates due to staff workload. Such analysis helps management determine whether caseload targets are negatively affecting service quality for clients.

Data on client treatment is generated from Social Performance Officers, who collect information on staff behavior directly from clients through three types of client interviews—focus groups, exit interviews, and business assessment interviews. This analysis is presented in a clear, visual report that management uses to discuss potential portfolio and client protection risks and how to mitigate them.

The tool generates actionable information for MicroLoan Foundation managers. For example, in 2014 the institution found that 33% of loan officers in the sample were not offering adequate support to clients having repayment difficulties, and this lack of support appeared to be linked to instances of higher than average PAR in the sample portfolio. With information like this, the institution will be able to make necessary adjustments to targets and incentives before they affect the institution’s overall portfolio.

## Special Thanks

In 2014, the Smart Campaign sent a request to several hundred financial institutions, asking for example staff incentive systems. Twenty-seven institutions shared their staff incentive system, several of which appear in this tool and/or helped to inform this tool and the Smart Campaign's ongoing work to provide guidance on staff incentives that protect clients.

The Smart Campaign would like to sincerely thank the following institutions for sharing their staff incentive system with us:

ACFIME-CREDO, Burkina Faso  
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CASHOPOR Micro Credit, India  
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