

## Strategic Value of Pay for Performance System in Korean Leading Bank: A Case Analysis of Shinhan Bank Korea

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**Abstract:** This case depicts Shinhan Bank's performance based evaluation systems, which contributed it to become a leading bank in Korea. There are two main performance based evaluation and pay systems Shinhan Bank implemented: Group based evaluation and Differential salary peak system. The former Group based evaluation is a re-formation of original relative evaluation of branch's performance with absolute evaluation of individual performance for the sake of fairness. The latter Differential salary peak system is an evaluation system that excludes high performance employees from being vulnerable of termination from salary peak by regulation in Korea. This system allows superior senior employees to carry out their long working experiences and expects to enhance morale and motivation. Differential salary peak system ultimately results in maximizing Shinhan Bank's productivity and profits. The case can be used for the topic of human resource management.

**Keywords:** Pay for Performance, Performance Evaluation, Differential Pay

### INTRODUCTION

Compensation refers to the reward received in exchange of employees' contribution, and is a statement of an employees' worth by an employer [1]. Compensation is one of important factors that influence both employees and companies, and to be an effective compensation, it should be related with the performance. First, effective compensation helps employees to raise their morale, and stimulates the employees to work better and show their excellence. Secondly, a good compensation also improves the employees' satisfaction of their workplaces, which further leads to an increase in their loyalty to organization. This helps to reduce the employees' turnover rate and unnecessary recruitment costs, enabling more stable state of organization [2]. Ultimately, a sufficient amount of compensation enhances organizational productivity and has a positive impact on the growth of the company. In this vein, it is very important for company to know how to operate the compensation system and create compensation plans tied to employee's performance.

Recently, Korean financial authorities have identified pressure on "Performance based compensation system" of financial institutions. However, a large number of financial institutions in Korea have been criticized for their poor productivity due to rigid wage structure that has minimal correlation with employee's performance level. To solve this problem, financial authorities have recommended that commercial banks should change their compensation system into more flexible system.

We focused on Shinhan Bank for our analysis for the following reasons. First, Shinhan Bank is maintaining the leading bank status in terms of net income in Korea for the last 6 years. The bank achieved a net income of 1.4897 trillion won in 2015, and still keeping up with its status as a number one bank [3]. Shinhan Bank also has the highest productivity among other banks. Compared to last two year's profits per capita of 6 commercial banks, Shinhan Bank is ranked No.1 with a 133 million won in 2015 and 146 million won in 2014 [4]. Secondly, Shinhan Bank especially has a reputation for having a highly performance based evaluation system. Shinhan Bank requires high level of performance from its employees, but at the same time, it rewards its employees' better performance with sufficient compensation. According to one of the Shinhan Bank employees who was interviewed through JobsN, job search online platform, Shinhan Bank is a type of company that you can make a 100 million lump sum of money through 3 years working in Shinhan Bank [5].

As mentioned above, Shinhan Bank is currently the number one leading bank in terms of net income and productivity per employee, and it is going to expand the performance-based system. In this study, we present two distinctive Shinhan bank's performance based compensation system compared to other Korea commercial banks. First, Shinhan Bank gives compensation through the mixing of group based performance with individual performance. Second, Shinhan Bank operates unconventional salary peak

system that applies employees differently. Furthermore, we investigated how its compensation system influence both employees and the corporate, and whether Shinhan Bank's pay-for-performance standard has contributed in becoming a successful leading bank.

#### COMPANY BACKGROUND

Shinhan Bank (SHB) is a bank headquartered in South Korea and was established in 1897 under the name Hanseong Bank, and is part of the Shinhan Financial Group. The bank operates for personal banking as well as corporate banking by providing retail, corporate, investment banking service, securities brokerage, insurance and etc. Shinhan Bank is the leading bank in South Korea in terms of asset under management, and about 950 locations within South Korea, it has one of the largest networks. The company has operations in the United States, Canada, Mexico, Germany, United Kingdom, Poland, Kazakhstan, Uzbekistan, Myanmar, India, Vietnam, Singapore, Cambodia, Japan, Hong Kong, and China [6]. Recently, in 2015, Shinhan Bank opened branches in Dubai and Manila, fortifying "Asian Financial Belt."

Historically, Hanseong Bank (former name of Shinhan Bank) was the first bank founded in Korea. In 1982, Hanseong Bank was reestablished under the name Shinhan Bank and it started as a small company, employing 279 employees within 3 branches. Shinhan Bank succeeded to transform itself as one of the largest banks in Korea. As of 2006, Shinhan Bank was consisting of total assets of KRW 176.9 trillion, an equity capital of KRW 9.7 trillion, 10,741 employees, and 1,026 branches.

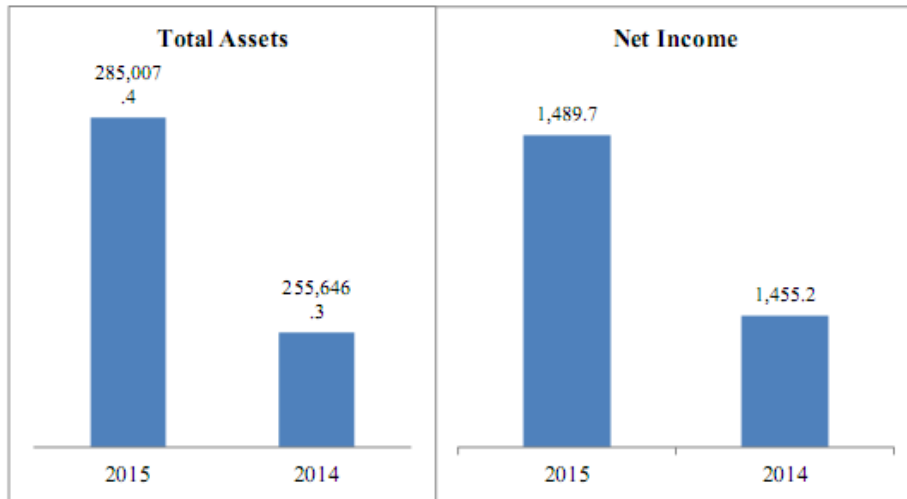
As of 2013, Shinhan Bank had total assets of KRW 313 trillion and total equity of KRW 28 trillion with more than 13,400 employees [7]. As of 2015, however, along with consolidation efforts, Shinhan Bank's total account assets increased by 11.5%, about KRW 285 trillion with 17,883 employees. There was a rise in loans of KRW 21.3 trillion as Shinhan Bank provided more mortgage loans to self-employed businesses. Total bank account liabilities rose by 12% because of low cost deposits. Moreover, Shinhan Bank's net income rose by 2.4% in 2015, reaching 1.49 trillion at the end of the year. Shinhan Bank was capable of

sustaining stable earnings despite decrease in interest income caused by drop in interest margins. Household and corporate loans increased by more than 10% and global operations contributed more than 10% of total earnings [8]. Hence, Shinhan Bank succeeded in growing up and becoming one of the main leaders of the bank industry in South Korea.

Additionally, Shinhan Bank won several awards, was named as the "Best Bank in Korea" by Asian Money Magazine for the tenth consecutive years in 2014, and was also named as the "Best Domestic Bank", "Best Private Bank in Korea", "Best Wealth Manager in Korea" by others magazine. Shinhan Bank was ranked No. 36 among 500 global banking brands by The Banker in 2015.

Shinhan Bank is a leading bank in Korea and has consistently been one as it started to focus more on profitability in response to the banking industry, suffering from slow growth and low interest rates. Specifically, according to first-quarter earnings report of 2016, Shinhan Financial Group is leading its local banking sector, with a 30 percent increase in net profits. Shinhan group's net profit in January through March period was 771.4 billion won, which is 30 percent increase from the same period compared with the last year [7]. Owing to improvements in banking and net interest margin, there was exponential growth in the profit. Although all of major commercial banking reported show enhancements in earnings, by far Shinhan group has the highest amount of earnings. Even Shinhan Bank President Yong-byoung Cho noted that he will try his best to further cement the leading bank status without fail [6].

Furthermore, Shinhan Bank expects to emerge as a world class bank by foraging greater amount of profits. Shinhan Bank aims to strengthen its presence especially in Vietnam and China by using "localization" as a key element to penetrate through the market. Moreover, in order to keep up with new business areas including financial technology, Shinhan Bank seeks to interact with information, communication and technology (ICT) companies in near future due to increase in use of online payments through mobile devices [6].



**Fig-1: Changes in Key Financial Performance**  
 Source: Shinhan bank Annual Report (2015) [8]

**Shinhan Bank’s Mission, Vision, and Value**

The company’s Moto is to practice “Friendly Finance for a Better Future.” The mission of Shinhan Bank is to be a companion for the future by building a better world through the power of finance. In addition, Shinhan Bank has 5 main core values. The first core value is that Shinhan Bank is customer oriented. It emphasizes trust, differentiated service, partnership and social contribution. The second core value is that Shinhan Bank shows mutual respect by emphasizing on greater a communication, fairness, teamwork, pursuit of the common interests. The third value is that Shinhan Bank aims to initiate change, using creative thinking, innovation, competitive edge, and continuous improvement. The fourth value is that Shinhan Bank orients toward the best by setting challenging goals, emphasizing strong execution: self-development and a good management of crisis. Final value is that Shinhan Bank puts the accent on ownership, pride being self-driven, fun and responsibility [3].

Moreover, Shinhan Bank’s Vision is to become the Number One bank that creates a new future and is loved by all. Shinhan Bank applies its vision to the customers, the market and the employees. For customers, Shinhan Bank seeks to become Korea’s beloved Number One bank which shares with its customers a vision of a better future. For the market, it wants to set new trends in the banking industry by overcoming the limits of the present banking industry through change and innovation. For employees, Shinhan Bank wants to create an environment where employees are honored to work all together knowing that they are members of Korea’s leading bank. Regarding the employees, Shinhan Bank extols a family friendly management [4].

**METHODS**

A variety of methods were utilized in examining the case study of Shinhan Bank including newspaper articles, academic researches, HRM technical books, and interview with the deputy head of the human resources management department of Shinhan Bank, Jonghui Byeon.

Some parts of interview questions include the following:

1. What is the compensation system of Shinhan Bank?
2. What is proportion of performance based compensation?
3. What is the standard for performance based evaluation?
4. How is performance evaluated?
5. Why started to implement performance based evaluation?
6. What is the influence of Differential Salary Peak?
7. What do you think of the correlation between compensation based system and employee’s satisfaction?

Among major banks in Korea, Shinhan Bank especially is well-known for its heavy weight performance based evaluation system [9]. An interview was conducted with, the deputy head of the human resources management department of Shinhan Bank, Jonghui Byeon in May 24, 2016 to find out specific details regarding Shinhan’s evaluation system. The current compensation system of Shinhan Bank consists of "basic salary+ welfare benefits+ management incentives+ etc." The performance-based portion of Shinhan’s compensation system accounts for approximately 20-30% of the entire compensation

system, with some differences according to job positions. The compensation for newly hired employees is relatively high, at 55 million KRW as of 2015 [9].

## ANALYSIS & FINDINGS

### Performance Measurement

The main criteria for performance evaluation is Key Performance Indicator (KPI), which combines aspects of finance, customers, and long-term strategies in a comprehensive manner. More specifically, the performances of branches are measured with scores from the KPI indicators and are rated on their relative performance compared with other branches. Individual performance is measured by MBO (Management by Objectives), measuring whether or not the goals set at the beginning of the year were achieved. In the process of performance measurement, the evaluators are assorted respectively for each line. For example, entry level employees are evaluated by their director-assistant managers- the manager, whereas, directors are evaluated by assistant managers- managers - head of the evaluators.

In addition, the annually held 'Overall Achievement Assessment Competition' reflects the emphasis on performance. The late 2015 Overall Achievement Assessment Competition provided opportunities for well performed employees to earn opportunities for promotions, reflecting the performance based evaluation system of Shinhan Bank [4]. In the event, the President of Shinhan, Yong-byoung Cho announced that Shinhan aims to "Provide opportunities for special promotions to employees who carry out Shinhan's core values in order to form a rightful compensation based culture and create an energetic working environment" [3]. This highlighted the fact that Shinhan Bank aims to provide other numerous opportunities aside from special promotions and lead change and innovation.

The reason for adopting a highly intensive performance based compensation system is to increase the employee's motivation, job commitment, and ultimately to improve productivity. Annually, the KPI index is altered to align with Shinhan Bank's objectives and is being used as a tool to achieve its goals. Questioned upon the effectiveness of Shinhan's performance based compensation system in the interview, Byeon replied that Shinhan Bank's performance evaluation system is appropriately suited to meet the goals of the organization.

Moreover, Shinhan Bank announced to change and specify its goal of KPI Index to focus on profitability. Shinhan Bank executive has indicated that currently the company's culture concentrates on the motives of employees which are related with raising

sales of financial products. However, Shinhan Bank realized that it is no longer important to increase sales of financial products. Rather, ultimate goal of Shinhan is to orient towards raising profitability of customer's asset. In 2014, this alteration in KPI Index was initiated and employees were positively evaluated as they generate more profits rather than to sell more financial products. Based on one-year simulation, Shinhan Bank hopes to implement newly improved KPI Index that reaches customer's goal with appropriate financial product and service. New KPI Index will not be solely applied to Shinhan Bank. Shinhan Investment Corporation has already conducted this new model. This new KPI Index will be applied to all branches of Shinhan Bank, ensuring profitability and performance based evaluation [10].

### Heading Toward Group Evaluation System

To start with, evaluation system based on branch's performance is a common method for evaluating employees in all banks including Shinhan Bank. This evaluation determines employee's wage based on salary step system. This system compensates employees by their length of working and bonuses are determined by branch's total performance, not by individual performance. In the case of bonus, the amount commensurate with achieving financial goal of branch and these bonuses account for 20~30 percentage of wages (salary step and annual salary system). This system inevitably compares employees' performances of one branch with other branch employees' performances.

Specifically, Shinhan Bank divides each branch according to its asset size into 5 rankings and conducts relative evaluation within the same grade. Mostly, one group consists of 10 branches. Approximately top 30% of branches receive fifth or fourth ranking, 40% of branches in the middle receive third ranking, and the bottom 30% of branches are ranked as the second or the first (the lowest level). Concerning these factors, Shinhan Bank's branch evaluation system is a 'Group Based Compensation System.' Important fact is that only those individual performances of employees in managerial position are reflected in the group based evaluation system. Especially as 60~70 percentage of bonuses are the results of group based compensation, this system is important and significant factor to both manager position employees but also to normal employees [11].

As a result, the problem of this system is that group based evaluation system does not reflect or recognize individual performances of all employees. Although some employees do not deserve to be ranked as 5, they receive the same amount of bonus just because there is an assumption that branch's high

ranking is due to entire employees' efforts and performances. Also, this evaluation system only reflects performance of employees in management position. Moreover, due to high relative evaluation system, although some branches fully achieved goals of organization, they are ranked as 2 or 1 (low levels). As a result, this system is difficult to compensate employees fairly and accurately because they are evaluated based on total branch performance and this causes negative impacts such as free riders, demotivation of employees [12].

Recently, Shinhan bank has revised an aspect of group based evaluation system. To solve this group based system's major weaknesses, Shinhan bank introduced absolute evaluation into current group based evaluation system. Specifically, when one branch gets over 10,000 scores on group based evaluation system, Shinhan bank treats this branch as the same as other branches ranked 3+ (high degree). This means that branch which receives over 10,000 scores is guaranteed to get at least the 3rd ranking, which is a high degree. However, if the branch is solely evaluated based on the relative system, it could have received just ranking 1 (the lowest). Therefore, Shinhan Bank's group based evaluation system is mixture of relative and absolute evaluation and this absolute evaluation offsets negative aspects of relative evaluation system [13].

#### **Differential Performance Based Salary Peak System**

Salary Peak is a system which assures regular retirement age or extends retirement age of senior employees in return for gradually reducing their salaries in the extended years [14]. Due to the recent global economic crisis, company was pressured to reduce their labor costs. Furthermore, the government regulated companies to create employment opportunities for young people. Companies, under the salary system based on seniority, had the incentive to pressure the middle-aged and the aged to layoffs and voluntary resignation. This, however, had backfire effect on companies due to exodus of highly experienced employees and employment instability which lowered the morale of workers.

As a result, the Salary Peak System was implemented as a means to achieve a win-win outcome for both employees and the firm. The expected effects of the system are employment stability, alleviation of companies' labor costs, usage of experienced workforce, solving personnel congestion. Nevertheless, its drawbacks are loss of vitality, difficulty in motivating due to wage reduction and productivity deterioration [15].

Korea Credit Guarantee Fund first adopted salary peak system in 2003 and domestic banks are also

among the first companies to adopt the system. Shinhan Bank has also applied the salary peak system. However, as to commensurate with Shinhan Bank's performance based system, the company has announced to implement 'Differential Salary Peak'. In 2015, out of 140 employees who are subjected to salary peak, 50 employees with superior performance will be excluded from being subjected to salary peak and will be able to keep on showing their competence in work without wage reduction [16].

According to the interview with Shinhan Bank's Deputy Head of Human Resources Management Department, Jonghui Byeon, the reason why Shinhan Bank has adopted Differential Salary Peak System is to allow those who perform well to keep their productivity. He mentioned that the company does not discriminate the employees on academic ability, gender, or even by their age. The standard to judge those with superior performance is based on past overall evaluation that has been accumulated for many years.

Shinhan Bank expects to boost senior employees' morale as well as organizations' vitality through the Differential Salary Peak system. With respect to profits, Shinhan Bank views that there also will be positive outcomes. Those selected in the system have outstanding capability as they have accumulated expertise through long working experiences. As a result, the company's profit will continue and superior senior employees can pass on their working abilities to their subordinates.

Shinhan Bank's positive view about their Differential Salary Peak is also supported by other experts in the field. According to Edaily news article, Yoon Seok Hyun, Professor of Finance in Soongsil University noted that it is worthy for other banks to consider the way how Shinhan Bank applied performance based system in salary peak. He further mentioned that the seniors in the financial field have human network as well as know-hows and it will be weakening the bank's competitiveness if these seniors are all under one unified criterion called salary peak system [17]. In addition, one president of a certain bank points out that it is a way of harming well performing employees' morale if their wage is decreased just because of their age and pushed out to back office. It is reasonable to let those who perform well to keep on working since their work is needed for increasing the bank's competitiveness [18].

Moreover, Shinhan Bank also expects that the differential salary peak can cut down personnel expenses which will have a positive effect on recruiting new employees. This has a thread of connection with the fundamental purpose of salary peak which was to



reduce a long-term employed person's wage and to solve the problem of unemployment among young people.

#### **Evaluation: Linking theory to practice**

Compensation is a reasonable payment for the efforts of employees, and is very important factor in human resources management because compensation is highly related to the self-esteem of employees. According to the compensation specialist Stephen E. Gross, a bigger reward for those employees who contribute more to the performance of the company is very crucial for the continued success of the company [1]. Pay for Performance standard is a way to increase company's productivity and also to reduce labor costs in today's competitive business environment. If compensation is not related to the employees' efforts and performance, they are likely to be demotivated to work hard. As a result, there could be decrease in productivity level. Also, due to low employee satisfaction, there is high turnover rate which in turn will increase labor costs.

According to Vroom's expectancy theory, motivation level of the individual is dependent on the possibility of getting compensation. In other words, employee's motivation is based on the compensation's attractiveness. Expectancy theory proposes that employees will behave in a certain way because they are motivated to select a specific behavior over other behaviors due to what they expect such as rewards [19]. Expectancy is the faith that better efforts will result in better performance. Higher performance will result in a more valuable compensation, and this means instrumentality of success in getting reward. Instrumentality is the faith that if you perform well, then a valid outcome will be there. Rewards ultimately lead to high satisfactory level of employees [19].

As indicated from the theory above, the degree of satisfaction and motivation of the employees vary according to the compensation they receive. Therefore, reasonable and fair compensations based on performance evaluation are highly influential in employees' motivation and satisfaction. According to the Deputy General Manager of the Human Resource Department at Shinhan Bank, Shinhan Bank employees are motivated to work hard because it emphasizes transparency and compensates employees based on their performances. He also mentioned that Shinhan Bank discloses the result of personal assessment unlike other commercial banks, and mixes the individual evaluation and department evaluation. As a result, such evaluation systems contribute to Shinhan Bank's fairness and increased employees' motivation to work. Under this atmosphere, individual employees are fully able to demonstrate their capabilities and lead healthy

competitions in the organization. Thus, according to the General Manager, these factors related to performance based compensation contributed to Shinhan Bank to become a leading bank, maintaining its No.1 status.

In addition, Shinhan Bank operates a performance evaluation system based on the KPI index, which is changed depending on the organization's purpose per year. Specifically, Shinhan Bank reflected the results of customer's earning rate, not the number of financial products sold by the employees in 2015 KPI index. This was the first time for Korean commercial banking sector to reflect customer's earning rate. Shinhan Bank decided to reflect the customer's earning rate in KPI index with the mission and purpose to increase customer's satisfaction. This shift also led to maximizing Shinhan Bank's profitability due to efficient operations. As a result, Shinhan Bank was acknowledged and received the international 'A-' credit rating [10]. In this regard, Shinhan Bank has made consistent efforts to link the compensation and evaluation system with organization's purpose, which ultimately took a significant role in organization's ongoing success.

Finally, as mentioned above, Shinhan Bank has also conducted a Differential Salary Peak System, and the company views that this system would generate profits because employees who have great capabilities can continue exerting accumulated experiences and skills. According to the interview, the General Manager stated that this system will reduce the labor costs of senior employees and therefore have positive effects on hiring new employees. Shinhan Bank will be able to enhance not only the morale of those employees who are close to Salary Peak but also the vitality of the organization. Older employees tend to lack motivation, with little hope for promotion, not improving the productivity of the organization. However, differential salary peak system motivates the older employees to strive for performances because they can work longer and receive more rewards. This continuity working of experienced employees eventually will have positive impact on the success of the organization, improving Shinhan Bank's competitiveness.

However, this new system is not without any limitation. One potential pitfall is how the system applies to employees from different level. It can be difficult to judge employees' performance because they are not all doing the same task. Due to the fact that the Performance Based Evaluation System tends to focus on results rather than the efforts put into the work, it can make some employees think that they are not treated with equity. This mainly applies to lower class job, because their job will not impact the company

performance as much as higher position. As a result, employees who are working well and in a position that generates revenues enjoy the system and this system will rather enact as a factor of demotivation due to imbalance return in compensation. One example showing that low class employees do not have the same advantages as higher class employees is that the salary peak system does not apply to lower class employees.

## CONCLUSIONS

Among many commercial banks in Korea, Shinhan Bank has own distinctive compensation culture that is high performance-based. According to many employees in Shinhan Bank, it has high intensity of workload and hierarchical military culture, but compensates with sufficient amount of rewards in accordance to how much employees have worked. Based on such culture, Shinhan Bank has formed evaluation system based on employees' performances, and implemented compensation system of performance oriented through their performance-based evaluation system.

Shinhan Bank has two distinctive performance based evaluation systems compared to other banks that include 'Group based evaluation' and 'Differential salary peak system.' First, Shinhan Bank's group based evaluation system is mixture of relative and absolute evaluation. Previously, Shinhan Bank only operated relative evaluation by the size of total assets per branch, and employees received the bonuses based on branch's overall performances, not by their individual performances. This absolute evaluation caused free riders within the branch and demotivation among lower positioned employees due to fairness issue. This unfairness ultimately had negative impact of Shinhan Bank's overall productivity. To solve these problems, Shinhan Bank incorporated absolute evaluation into current group based evaluation system. Second, Shinhan Bank implemented Differential salary peak system that excludes high-performance employees from being subjected to salary peak. Since most employees want to keep up with their work without wage reduction, they work hard to achieve high-performances. Superior employees who have been selected in this system can fully demonstrate their abilities from their long working experiences, and Shinhan bank expects to increase senior employees' morale and motivations. Differential salary peak system ultimately contributes in maximizing Shinhan Bank's productivity and profits.

Evaluation and compensation systems are very important for both employees and corporations. Employee satisfaction tends to depend on whether compensation and evaluation are highly linked to their performances, and the fairness of the performance

based evaluations. In the case of Shinhan bank, it has two major performance based evaluation systems: 'Group based evaluation' and 'Differential salary peak system.' Through these performance based evaluation systems, Shinhan Bank ensures transparent and fair evaluation by disclosing the results of individual's performance unlike other banks. As a result, Shinhan Bank's employees' satisfaction increased, and this contributed in improving employees' morale and motivation. Furthermore, from company's perspective, there is an increase in productivity and profits as employees have great amount of satisfaction level with the organization due to fair standard of evaluation system. Hence, Shinhan Bank's performance based evaluation system led to increase in employees' satisfaction and Shinhan Bank's overall performance. Shinhan also changes KPI index annually, which is a standard for evaluation system to reflect organization's purpose appropriately and to contribute to overall performance.

Therefore, Shinhan Bank's performance based evaluation and compensation system have positive effects on the employees' satisfaction and Shinhan's performance, allowing it to maintain a leading bank position for six years. However, ironically, Shinhan Bank still has a hierarchical military culture. It is ironic that the performance based systems and military culture coexist in one organization. Shinhan Bank should put more efforts to reduce the hierarchical military culture, and have a more flexible and horizontal organization culture. If Shinhan's performance-based systems and flexible culture are combined, there will greater synergies than nowadays in enhancing the employees' satisfaction and Shinhan's performance.

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