

Reducing incentives for fraud and corruption in skills programmes in Bangladesh

Can new strategies target productivity and better skills to reduce fraud?

Research Question

Skills training by private firms in Bangladesh is not necessarily resulting in higher rates of employment, better paid employees or more productivity, and levels of fraud can be high. Private training providers (PTPs) in Bangladesh are usually incentivized to provide skills that generate employment: one-third of their payment per trainee is released when the trainee finds employment. In practice, there is significant fraud in overstating employment. Up to a third of public resources may be wasted in this way, and the true cost is much higher. How can an anti-corruption strategy improve skills training outcomes, reduce corruption and achieve better productivity outcomes for employers?

Key Findings

Analysis of invoices from private training providers confirmed our hypothesis that training providers to supply high capability firms engage in less fraud in overstating trainee outcomes in order to claim payment. Our findings suggest that standard monitoring and audits are insufficient to control fraud – an alternative strategy is needed.

Implications

Our anti-corruption analysis supports other evidence from Bangladesh that shows that feasible investments in firm organizational capabilities combined with simultaneous skills training can achieve productivity growth of up to 30% in less than a year. If firms achieve this kind of return, they are likely to seek out skilled workers, and training providers will have far less incentive to engage in fraud. We propose changes to the design of skills funding programmes to link PTPs to clusters of firms whose capabilities are being enhanced in parallel, to reduce fraud and improve skills training outcomes and productivity.

Project Summary

The garments sector is a major exporter and employer in Bangladesh, and around 80% of employees are low-income women. Skills training programmes should enable workers to increase their skills and make firms more productive, enabling faster employment and wage growth. However, while complaining about the lack of skills, Bangladeshi garments factories are curiously reluctant to pay for training, and often prefer to employ slightly cheaper unskilled workers at the factory gates.

Fraud occurs when private training providers (PTPs) whose payments are linked to results overstate employment success of their trainees, sometimes in collusion with agencies charged with releasing payments. Our initial informal investigations suggested between ten to thirty percent of resources may be wasted due to fraud, and the true cost is much higher because this fraud creates further incentives for poor quality training.

To solve this puzzle we use insights from research on the determinants of productivity. The productivity of a worker in a factory depends jointly on the skill of the worker and the organizational capability of the factory. The latter describes the

organization of the factory, its production layout, quality control, inventory management and so on. A badly organized factory is not likely to observe any significant improvement in productivity by putting a skilled worker onto a poorly functioning production line. In contrast, in a factory with high organizational capabilities, an unskilled worker slows down the production line and skill deficits are easily detected.

Our hypothesis is that when Private Training Providers (PTPs) supply mainly to firms with higher organizational capabilities, their incentive for corruption in overstating employment outcomes is low because training effort gets immediate results in terms of high levels of trainees securing jobs. Moreover, PTPs that provide poor training are more likely to be identified by high capability employers and will not be able to overstate results for long.

We propose that if only politically-connected companies bid, the ensuing cost escalation cannot be controlled using regulatory enforcement strategies. The only feasible strategy is to induce competent companies to bid. Indeed, once high-cost technologies are installed there may be nothing much

that can be done. This research seeks to verify our hypothesis with hard data and to suggest how financing structures can reduce risk for politically unconnected investors, addressing the risk of collusion and increasing competition to create a more productive power sector. This may be the most feasible way

of improving regulatory compliance and the enforcement of procurement rules, by expanding the participation of competing investors who have an interest in identifying and reporting violations and demanding redress.

Methodology and key findings

- To establish the hypothesis, the research looks at the relationship between the degree to which different PTPs engage in misinvoicing when they claim payments and the characteristics of the employers they supply trainees to.
- We have detailed employee and trainee-level data for a dozen PTPs in Bangladesh. All of the PTPs we looked at were higher levels of external checking of invoices than the average in Bangladesh. We investigated the causes of corruption in this subset, and we believe our results will be even more applicable to other training providers with laxer quality control and monitoring.
- Our data set is unique because data on fraud are very hard to collect. We were able to access the data because of the participation of partners engaged in the management of skills who were interested in understanding the incentive misalignments that were creating incentives for misreporting by PTPs.
- To test the hypothesis that the incentive structure was itself creating strong incentives for misrepresentation of PTPs if they were unlucky to be supplying workers to firms with low organisational capabilities, we needed to construct an index of organisational capabilities for all the firms that the PTPs were supplying trainees to.
- We used unpublished data on firm-level exports over this period from the National Board of Revenue (NBR) to build an index proxying the organizational capabilities of the firms involved. We used other proxies including internationally certified compliance with building codes and an index for the type of firm to code for organizational capabilities. We then used a principal components method for creating a composite index of the 'average' organizational capabilities of the firms to which each PTP supplied trainees.
- We find a negative relationship between the average quality of firms that a PTP supplies to and the level of fraud by the PTP, which is remarkable given the high level of noise in our limited data set on fraud.

Implications

The evidence suggests that standard incentives and monitoring are insufficient to control fraud because many PTPs that supply to low capability firms cannot generate sufficient revenue without fraud. Other evidence from Bangladesh also shows that feasible investments in improving firm organizational capabilities combined with simultaneous skills training can achieve productivity growth of up to 30% in less than a year. If firms achieve this kind of return, they are likely to seek out skilled workers. Moreover, PTPs that provide skills to these high-capability firms will not have to engage in fraud. By changing the design of skills programmes to link PTPs to clusters of firms whose capabilities are being enhanced in parallel upgrading programmes, the incentives for fraud by PTPs will be significantly reduced and support created within the sector to identify and weed out the minority of PTPs who continue to engage in fraud.

The research suggests that corruption and fraud in skills training programmes may be a result of an inappropriate design of incentives to improve the marketability of skills, while monitoring and enforcement does not work well, even in very well-managed programmes. A feasible and effective anti-corruption strategy would be to jointly support skills training together with support for the organizational upgrading of firms. This approach has already been followed in Bangladesh with excellent results, but has not been recognized as an anti-corruption strategy. A joined-up policy may create support for more effective monitoring and enforcement because a significant number of insiders including both PTPs and employing firms will support the implementation of the strategy and help to identify and exclude the minority who may continue to engage in fraud because they have no capacity to provide high quality training.

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