SMARTAID FOR MICROFINANCE INDEX 2009

SWISS AGENCY FOR DEVELOPMENT AND COOPERATION (SDC)

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Background

The SmartAid for Microfinance Index measures and rates the way microfinance funders work. Heads of 29 major development institutions endorsed CGAP's development of the Index.[1]

The premise of SmartAid is simple: funders with strong management systems are better equipped to support microfinance effectively. Its indicators assess five areas agreed by all funders as critical for effective microfinance: strategic clarity, staff capacity, accountability for results, knowledge management, and appropriate instruments.

SmartAid enables funders to understand how their systems, policies, procedures, and incentives affect their work in microfinance. An independent, external assessment, the Index highlights strengths and areas for improvement. It can also provide an impetus for funders to take action, prioritize changes, and hold themselves to account for their own performance.

Funders support microfinance with the goal of reducing poor people's vulnerabilities and increasing their incomes. Having the right systems is a necessary, not sufficient, condition for achieving this goal. SmartAid does not, however, evaluate the quality of programs on-the-ground.

SmartAid Indicators	
1	Funder has a policy and strategy that addresses microfinance, is in line with good practice, and is based on its capabilities and constraints
2	Funder has designated microfinance specialist(s) who are responsible for technical quality assurance throughout the project/investment cycle
3	Funder invests in microfinance/access to finance human resources
4	Funder has a system in place that flags all microfinance programs and components
5	Funder tracks and reports on performance indicators for microfinance programs and components
6	Funder uses performance-based contracts in its microfinance programs and components
7	Funder regularly conducts portfolio reviews
8	Funder has systems and resources for active knowledge management for microfinance
9	Funder has appropriate instrument(s) to support the development of local financial markets

Ten funders—AECID, AFD, AfDB, EC, GTZ, IFAD, ILO, MIF, SDC, and UNCDF—participated in SmartAid 2009. This diverse group includes development finance institutions focusing mainly on mature retail institutions, large multilateral development institutions that make sovereign loans to governments, and bilateral and multilateral agencies that primarily provide grants.

The Index presents a standard appropriate for all types of donors and investors. However, good performance against the indicators can take different forms for different agencies. Systems that work can look radically different across funders, based on numerous factors including size, level of centralization, and strategy.

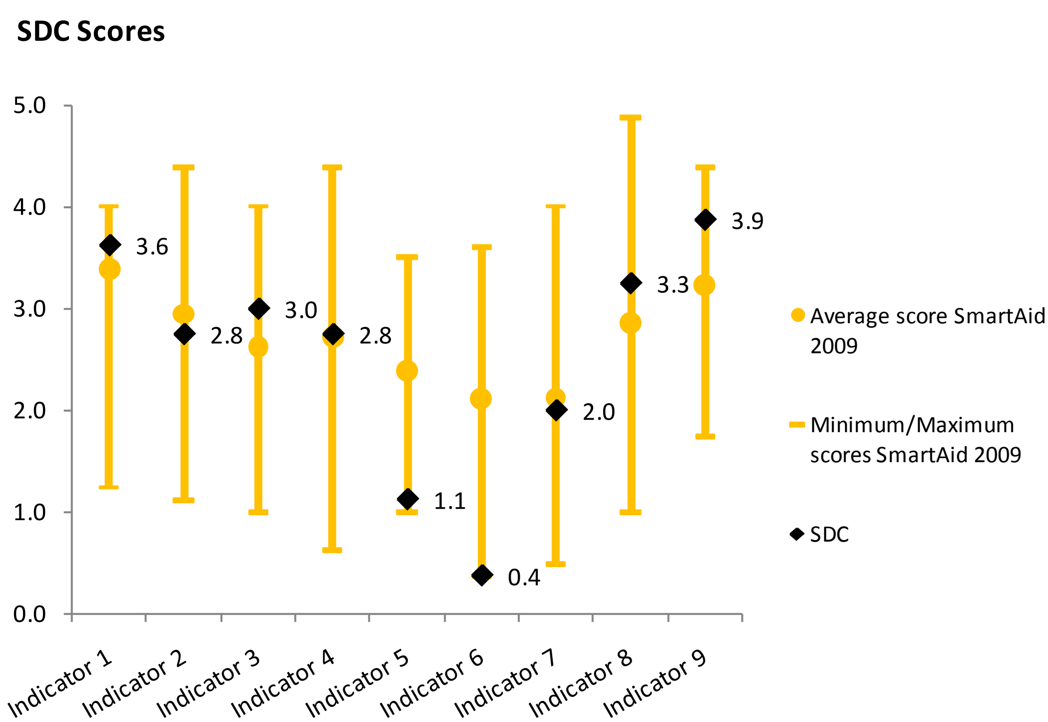
[1] See the Better Aid for Access to Finance meeting, 2006: www.cgap.org/betteraid_meeting/compact.

Key Findings

At a Glance	
Type of funder:	Bilateral Agency
Microfinance portfolio (committed as of 12/2007):	$78 million
Microfinance as % of total portfolio:	0.7%
Number of projects:	35
Primary level(s) of intervention:	☑ Retail ☑ Infrastructure ☑ Policy
Primary instrument(s):	Grant
Primary source of funding:	Public funds

SDC received 52 out of 100 points, meaning that the agency's systems are "partially adequate" to support microfinance effectively. As the graph below shows, SDC's strongest performance is in strategic clarity, knowledge management, and appropriate instruments (indicators 1, 8, and 9). For each of these indicators SDC scored over 3, on a scale of 0 to 5. However, SDC's performance is very poor in the use of performance-based contracts, performance tracking and portfolio reviews (indicators 5, 6, and 7).

SDC shows great discernment in its continual assessment of where and how it can best add value. The agency is sensitive to how it fits into the funding landscape, especially as the landscape evolves quickly and the roles of funders change with the entry of commercial players. SDC uses a fully diversified range of instruments (grants, equity, debt, and guarantees) and enjoys great flexibility to work at all levels of the financial system and with a broad range of partners. The agency incontestably has the vision and instruments to be an effective funder in microfinance. Knowledge management is important to SDC, and it invests in generating and sharing knowledge broadly. But the lack of mandate for quality assurance and for enforcing standards threatens good performance in the above areas. Especially with a decentralized structure where many decisions are made in country offices, having mechanisms in place to understand the performance of the overall portfolio and to assure common quality standards across all of SDC is necessary.



Strengths

- **Policy for Financial Sector Development demonstrates good understanding of financial market development.** SDC's policy is thoughtful, and clearly defines the function and relevance of the financial sector. The policy emphasizes understanding the country context starting with clients, rather than prescribing one right way to do microfinance. The tone and content of the document reflect SDC's commitment—and ability—to be flexible and responsive to dynamic market conditions. SDC also recognizes the difficulties and risks of intervening in an essentially private sector activity, and the policy includes a strong caution against hampering savings mobilization. Endorsed and disseminated by the head of the agency, the policy is user-friendly and targeted to decision-makers at headquarters, cooperation offices, and consultants. The Manual on Managing Cooperation in Financial Sector Development (PCM) promises to help operationalize the vision laid out in the policy.

- **SDC's value-added at all levels of the financial sector is well-defined.** The policy goes beyond describing the financial sector development approach, to clearly articulating SDC's goals, role, and possible actions with regards to clients, and the retail, infrastructure, and policy levels. This articulation allows staff to understand the big picture and how they can take action, explicitly placing value on collaboration with other donors. At the retail level, SDC stresses working with institutions that share its values and goals to improve governance, management, and internal controls. At the infrastructure level, SDC's comparative advantage is to support networks, training organizations, and transparency through ratings. Finally, SDC recognizes its limited advantage at the policy level, but leaves an opening for some work in collaboration with other donors in countries where it has a long history, in-country presence, and is a trusted partner to the government.

- **Focal point expertise and experience is solid.** The focal point has broad experience in microfinance that is fully appropriate for SDC's requirements. Importantly, focal point staff have lived and worked in developing and transition countries, which is critical to their ability to relate well to colleagues and partners in the countries were SDC is present. The specialists are proactive in organizing learning events, developing operational guidelines, and manually sorting through project proposals to keep a running list of microfinance projects.

- **FSD-specific positions in high portfolio countries.** Assigning staff specifically to financial sector development on a full or part-time basis in country offices with significant microfinance programming is a good strategy. The availability of microfinance expertise in-country is all the more important given SDC's relatively decentralized structure whereby quality assurance depends first and foremost on program staff in field offices.

- **Budget and procurement flexibility to access quality consultants available.** SDC successfully leverages external resources to strengthen its technical capacity in microfinance. The contract with Intercooperation is a creative way to ensure permanent, immediate access to extra resources that provide a helpdesk function. The use of excellent consultants also helps bring in expert opinions. The mix of local and international consultants effectively matches SDC's strategy of understanding and adapting to the local context.

Good Practice Highlight

From Policy to Practice: Providing Staff with Operational Tools and Resources

SDC's Manual on Managing Cooperation in Financial Sector Development is a creative way to link policy guidance to the project cycle. Complete with checklists, additional references and resources, the manual anticipates the everyday work of program staff and seeks to reduce their work load by providing tips and templates in an accessible form. Its modular format allows for additions and regular updates as the field changes.

- **Vigorous program of knowledge exchange benefits industry.** SDC's strength in knowledge management seems driven by a healthy intellectual curiosity about issues that affect poor people's access to financial services. Ahead of many of its peers, SDC emphasized savings, rural finance, and capacity development. It has commissioned numerous case studies on these topics that are publicly available. Through SDC's semi-annual Savings and Credit Forum and the annual Financial Sector Development seminar, SDC staff, NGOs that receive about 50 percent of the agency's microfinance funding, and the Swiss microfinance community at large benefit from discussions on topical issues like guarantees, insurance, and social performance monitoring, often with invited outside guests. Internally, the agency also prioritizes knowledge management in job descriptions, the backstopping contract with Intercooperation, and the newly restructured employment and income network.
- **Full palette of flexible instruments ready to be adapted to local needs.** SDC has five clearly defined instruments that fit its strategy. They can be used directly with the private sector and for-profit actors, which is particularly useful for work at the infrastructure level, for example with private training firms or rating agencies. Recent guidance on working with the private sector addresses pricing and local currency to help SDC intervene in markets with minimal negative externalities.

Weaknesses

- **Focal point lacks mandate and authority for quality assurance.** The absence of a clear mandate for quality assurance and reduced thematic resources has the potential to negatively affect the ability of the focal point to support all parts of the project cycle from review of project designs to monitoring performance. While strong social and negotiating skills are indeed required for technical experts to engage with generalist colleagues, over-reliance on these skills to the detriment of any formal authority for quality assurance has risks. Moreover, the guidance does not explicitly state that colleagues should contact the focal point staff as a first step in the project design phase. This appears to further undermine the role of the focal point. The weak position of the focal point is unfortunate, given that this is where the best microfinance expertise in SDC is concentrated.
- **Performance tracking and reporting is not systematically enforced.** There is no evidence that performance indicators related to microfinance programming are systematically collected, analyzed, and used, especially beyond the project level. The numerous project reports reviewed have little core performance reporting, especially on collection (portfolio quality) and profitability. The Meta Evaluation of 2005 also confirmed that indicators used are often not in line with standards set by SDC itself. Essentially, this means that management has no visible means to supervise performance and the focal point is not able to report on the results of projects. Consequently, it is difficult to generate much internal knowledge sharing across country offices since the focal point is best suited to perform this role, but remains without vital information (or receives it only at project completion).
- **Review of overall portfolio performance is missing.** SDC has not conducted a comprehensive review of microfinance that specifically checks the performance of its whole portfolio, or a major portion thereof, as well as compliance with SDC's policies and the quality of SDC's inputs. The power of this type of portfolio review is that it highlights patterns of what worked well and what did not with an emphasis on what SDC as a whole can learn, not just the individuals involved in a specific project. The findings can then feed back into strategy fine-tuning, operations, and future programming. Experience suggests that while necessary and helpful, evaluations or reviews of individual projects at the country level rarely lead to strategic or operational changes in how a funder designs and implements programs. Broad evaluations

like the Meta Evaluation, Thirty Years of SDC's Engagement with Rural Finance in India, Assessment of Potential Exit Strategies for SDC's Financial Sector Projects in Pakistan are useful since they did consider all or a big part of the portfolio, but are insufficient since they contained little performance information (e.g., portfolio-at-risk, return on assets).

- **Contracts with partners are not conditioned on performance.** All legal contracts include covenants, such as clauses that condition payment on the receipt of reports. However, such clauses are not sufficient to set unambiguous milestones of performance with partners, linked to the objective of the funding or technical assistance provided. Using performance-based contracts that include minimum performance targets, a monitoring plan, and consequences for non-compliance would be important for SDC to have up-front, clear expectations about performance with its partners.
- **Flagging system not able to capture all microfinance components.** SDC's SAP system is not able to catch all components in non-financial programs, thereby risking that these components do not receive sufficient technical attention throughout the project cycle. The focal point's manual system of reading project proposals to identify components is a second-best solution that may work decently given the small size of the portfolio, but is likely inefficient.
- **Guidance on credit funds equivocal.** The FSD policy eloquently cautions about using credit funds in non-financial development programs but, along with the PCM, leaves the option open to staff discretion. The PCM indicates that microfinance expertise must be ensured in the case of credit funds, but that document is not yet approved or binding, and actual practice is unclear.
- **Country office staff do not appear sufficiently engaged in knowledge sharing and learning events.** Having staff with critical decision-making power spread across continents poses specific challenges for training and knowledge management. Country office staff have difficult or infrequent access to Switzerland-based events. Yet they could particularly benefit from more training given that some had limited microfinance/FSD experience prior to joining SDC and also the pace of change in microfinance. Moreover, since much of the performance information about projects stays at the country level, opportunities for more face-to-face interactions across regions and with Berne seem indispensable to maximize learning.

Recommendations

As a decentralized bilateral agency where microfinance is firmly anchored within financial sector development, SDC is well-positioned to take risks, innovate, and support partners with a long-term perspective. It has integrated international good practice in its policy and operational documents and is open and eager to collaborate with others. Indeed, SDC identified where it can add value at the retail and infrastructure levels, and where it can cooperate closely with others, for example, at the policy level.

Understanding local country conditions and being responsive to partners' needs is a core SDC value. This value is a positive quality reflected in the agency's organizational structure and culture, whereby decision-making is devolved to staff closest to partners—those in the country offices. The other side of responsiveness, flexibility, and openness, however, appears to be a somewhat laissez-faire approach about whether standards, policies, and procedures in place are followed. Indeed, the 2003 Peer Review and 2005 Meta Evaluation of Financial Sector Projects and Programs cited problems with accountability systems and the inconsistent application of guidelines set out in the strategy documents.

The FSD Policy 1998 revealed SDC's clear vision for financial sector development that was further reinforced in the 2007 Policy Update. Following the Peer Review, SDC has taken several steps to improve its work in microfinance, including developing operational tools, most notably the PCM.

The current challenge remains developing processes and enforcement mechanisms for systematic implementation of the existing standards and tools. It will require management resolve and a clear mandate for quality assurance for the focal point to maintain minimum quality standards even with greater decentralization. Achieving the delicate balance between agency-wide adherence to core standards of good practice and decentralized responsibilities is a goal SDC can strive toward.

To make further progress, SDC will require management backing and resources for instilling strong systems for quality assurance; the tools and training to implement quality standards across all country offices; and mechanisms to check compliance and feed learning back into new designs.

The following specific suggestions emerge from the SmartAid review:

- **Management should strengthen the Employment and Income Network's mandate for quality assurance.** Decentralization has numerous benefits, including more nimble and responsive interaction with partners. However, decentralization also requires strong support functions to help align staff and programs around operational principles in the policy. These principles allow for sufficient flexibility to tailor programs to country context while providing an overall framework based on good practices. Ensuring adherence to good practices and the policy requires that the focal point consult with colleagues actively throughout the project cycle. The microfinance focal point should be given the mandate to review all program designs early on, for both stand-alone projects and components. The focal point's technical remarks could be circulated to all relevant parties and filed with the project documents. Beyond project design, the focal point should continue to play a quality assurance role, for example by reviewing performance monitoring reports.
- **Streamline, enforce, and update regularly the PCM as a priority.** The PCM, with its clear guidance on how to make the FSD policy operational promises to provide program staff with the tools to make their everyday work easier and better. Simple "do's and don'ts" could make it more user-friendly. The PCM should also be clear about what guidance is suggestive and what is binding. To ensure the PCM is a useful living document, it would be useful to periodically seek inputs and review from the manual's target audience—staff in field offices. Once approved by management, the manual should be further rolled out through training sessions to ensure staff feel ownership and are well-equipped to use it. Two sections are particularly important: performance tracking and an anticipated annex on performance-based contracts.
    - <u>Performance Tracking</u>. Starting with the indicators included in the PCM, the focal point should help develop a system to track, collect and analyze performance information. All program staff with microfinance programs or components should be required to track and report to the focal point on core performance indicators for retail projects. The focal point should also be able to help troubleshoot when projects have a hard time producing the required information.
    - <u>Performance-based Contracting.</u> The annex on performance-based contracts should include guidance on how country office staff can work with their partners to agree on core performance indicators, performance targets, and consequences for non-compliance to be included in all retail project contracts. Performance targets should be set jointly with partners in line with their business plans, reinforcing the close relationships and collaborative process that SDC country staff have with their partners. Including performance targets in contracts provide continuity and clarity to partners should there be changes in SDC country office staff over time. It is also useful to provide clarity for SDC itself to justify its ongoing funding to partners.

Management should institute a requirement that these types of contracts be used for all new retail projects, or those being extended. When funding to a retail provider passes through an intermediary, SDC should ask that the intermediary also adopt this type of contract. However, performance-based contracts are only relevant if they are carefully monitored and enforced. Specific staff with the expertise and authority to follow-up with partners should be assigned to this task. The focal point should engage with country office staff and the contracts office early on to help review and enforce the performance-based contracts.

Finally, the PCM should be seen as living document, and regular updates should be planned to keep up with the evolution of microfinance and incorporate feedback from staff.

- **Check compliance with policy and PCM systematically.** SDC should build-in checks to verify if minimum quality standards agreed upon in the policy and PCM are applied across all microfinance projects and components. Such checks will serve the dual role of providing incentives for compliance as well as providing a better picture of what standards and tools are used and whether more needs to be done internally to maximize SDC's ability to deliver effective programs.
- **Ensure all staff managing microfinance receive training**. This firstly calls for identifying all staff working on microfinance, and requiring that those who manage a certain portfolio volume attend several days of training. The content can be tailored based on the results of a learning needs assessment, but should at minimum cover the PCM. It would also be good to find ways that the Switzerland-based seminars can be shared with the field. Even the most experienced staff can benefit from ongoing professional development given the pace of change in microfinance.
- **Commission an in-depth portfolio review.** The review should take a look at on-the-ground project performance for a cross-section of the portfolio, including all credit funds in non-financial development programs. The results of the review will undoubtedly provide an excellent feedback loop to management and staff about how SDC works in microfinance, including successes to replicate and mistakes to avoid. The review will also be a meaningful complement to the SmartAid for Microfinance Index that focuses on management systems, but not quality of programming on-the-ground.

Methodology

SmartAid distills learning from over seven years of aid effectiveness work undertaken by CGAP with its members. The indicators draw on the consensus *Good Practice Guidelines for Funders of Microfinance* and a body of knowledge developed through peer reviews, country reviews, and portfolio reviews. Aid effectiveness experts from the Center for Global Development and OECD's Development Assistance Committee contributed crucial advice.

Feedback from funders confirmed that the five core areas of effectiveness at the heart of SmartAid present a comprehensive picture of what funders need to support microfinance effectively. After a pilot round in 2007 and an external evaluation, the Index was refined and streamlined. SmartAid 2009 is thus the baseline year.

Points	Range
90–100	Very Good
80–89	
70–79	Good
60–69	
50–59	Partially Adequate
40–49	
30–39	Weak
20–29	
10–19	Inadequate
0–9	

SmartAid 2009 uses nine indicators to assess funders' internal management systems. Indicators are worth between 10 and 15 points each, for a total maximum of 100 points (see table). Different weights are assigned to indicators, giving more prominence to those that make a greater difference in a funders' work in microfinance. Accountability for results is a powerful element and accounts for 40 percent of the score. As the wise dictum goes, what cannot be measured, cannot be managed.

The Index is based on self-reported documentation from participating funders, following instructions in the SmartAid Submission Guide. Scores are determined by a review board of four microfinance specialists with broad experience with a range of funders. Each review board member independently scores all funders against all indicators; final scores are agreed upon after discussion among reviewers. For each indicator, funders receive a score on a 0-5 scale (5 being the highest score). These scores are then multiplied by a factor of two or three to arrive at the 100 point scale. Averages as well as minimum and maximum scores shown in the graph in the Key Findings section change depending on the funders participating in each SmartAid round.

Dispersion among reviewers for the final scores was minimal. For all scores (per indicator and funder), the standard deviation was less than 0.5. Naturally, as a margin of error is unavoidable in this nature of exercise; funders should not give undue attention to differences of one or two points. The most strong and meaningful messages lie in where a funder performs along the range of scores for each indicator as well as whether its overall performance lies in the "very good," "good," "partially adequate," "weak," or "inadequate," range.

It may be difficult for funders to make improvements in all indicators simultaneously, but experience suggests that even the largest of institutions can make positive changes. Over time, CGAP will perform trend analysis on SmartAid results to track evolutions within and across microfinance funders.

SmartAid for Microfinance Index Indicators			
Strategic Clarity	**1**	Funder has a policy and strategy that addresses microfinance, is in line with good practice, and is based on its capabilities and constraints	15%
Staff Capacity	**2**	Funder has designated microfinance specialist(s) who are responsible for technical quality assurance throughout the project/investment cycle	15%
	3	Funder invests in microfinance/access to finance human resources	10%
Accountability for Results	**4**	Funder has a system in place that flags all microfinance programs and components	10%
	5	Funder tracks and reports on performance indicators for microfinance programs and components	10%
	6	Funder uses performance-based contracts in its microfinance programs and components	10%
	7	Funder regularly conducts portfolio reviews	10%
Knowledge Management	**8**	Funder has systems and resources for active knowledge management for microfinance	10%
Appropriate Instruments	**9**	Funder has appropriate instrument(s) to support the development of local financial markets	10%

Funders participating in SmartAid 2009

Agencia Española de Cooperación Internacional para Desarrollo (AECID), Agence Française de Développement (AFD), African Development Bank (AfDB), European Commission (EC), Gesellschaft für technische Zusammenarbeit (GTZ), International Fund for Agricultural Development (IFAD), International Labour Organization (ILO), Multilateral Investment Fund (MIF), Swiss Agency for Development and Cooperation (SDC), United Nations Capital Development Fund (UNCDF)

About CGAP

CGAP is an independent policy and research center dedicated to advancing financial access for the world's poor. It is supported by over 30 development agencies and private foundations who share a common mission to alleviate poverty. Housed at the World Bank, CGAP provides market intelligence, promotes standards, develops innovative solutions, and offers advisory services to governments, microfinance providers, donors, and investors.

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