

Improving Effectiveness from Within: SmartAid for Microfinance Index

Quality, not just quantity, of aid matters. But measuring the quality of development assistance has continued to elude the development community. The SmartAid for Microfinance Index is an innovative tool that measures one part of the effectiveness equation: funders' internal management systems.

Quality matters

In the development world, the focus usually is on how much money is spent and not so much on how effectively it is spent. Staunch advocates of development assistance make loud and clear calls for increasing aid amounts. Skeptics, on the other hand, question whether aid works at all and argue for cutting aid budgets. Debates on "more aid" and "dead aid" often do not address a more relevant need: "better aid." Some of the obstacles to better aid are beyond the influence of donors and public investors. But other obstacles relate to funders' own internal systems, and they should be able to overcome them.

There are numerous steps along the complex development path to achieve positive impact on the lives of poor people. SmartAid focuses on one of these steps and is built on the premise that strong internal management systems lead to better programs on the ground.

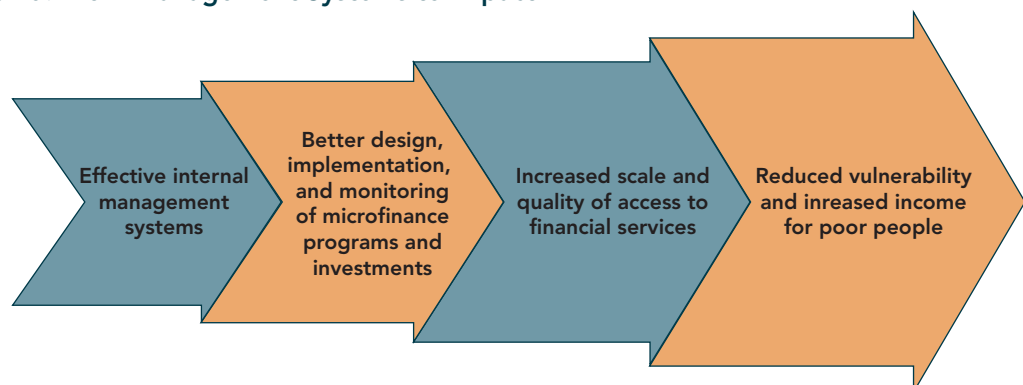
SmartAid was developed based on more than five years of collaboration with a broad range of microfinance funders. From this collaboration, five elements emerged as key to effectiveness: strategic clarity, staff capacity, accountability for results, knowledge management, and appropriate instruments. With the help of academics and aid effectiveness experts, the five elements were translated into the nine indicators embodied in SmartAid.

Measuring how funders work

At the 2006 "Better Aid for Access to Finance" meeting, 29 major development institutions took one step toward better aid by asking CGAP to develop an index that rates how well equipped they are to design, implement, and monitor microfinance programs and investments.¹ The result is the SmartAid for Microfinance Index.

An expert Review Board assesses documentation submitted by funders and applies scores to the nine indicators. Each funder receives a SmartAid report including comments on strengths, weaknesses, and recommended improvements, as well as quantitative scores.

SmartAid: From Management Systems to Impact



SmartAid 2009 Indicators

Strategic Clarity	1	Funder has a policy and a strategy that address microfinance, are in line with good practice, and are based on its capabilities and constraints	15%
Staff Capacity	2	Funder has designated microfinance specialists 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%

The pioneers

In 2007, seven funders participated in the pilot round of SmartAid; 11 participated in 2009. SmartAid participants include development finance institutions (DFIs) that mainly provide debt and equity investments in mature retail financial institutions; large multilateral development agencies that make sovereign loans to governments; and bilateral agencies that primarily offer grants. Taken together, these early SmartAid participants had \$8.2 billion committed to microfinance as of December 2008, representing more than half of the total commitments by cross-border funders to microfinance.²

SmartAid is an appropriate tool for all types of donors and investors. However, good performance can take different forms at different institutions. Size, level of centralization, and strategy all affect the kinds of systems needed. For instance, tracking and quality control are more challenging for a large, decentralized, multi-sector funder than for a smaller, more centralized agency, or for one more narrowly focused on private or financial sector development.

The early results

The results to date show some consistent patterns of strengths and weaknesses across funders. In 2009, funders tended to score best on indicators of strategic clarity (indicator 1) and appropriate instruments (indicator 9). The lowest scores were in the category of accountability for results (indicators 4, 5, 6, and 7). Out of a total of 100 points, the range of scores went from 35 to 75, with no funder falling in either extreme of performance—"very good" or "inadequate."

	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	

² CGAP 2009 Microfinance Funder Survey.

SmartAid 2009 Range of Scores



The high scores on **strategic clarity** reflect widespread progress in defining a common vision and basic good practice principles for microfinance—scores in this area would have been markedly lower 10 years ago. However, translating good strategies and policies into actual practice throughout an agency is difficult. Without the right staff and accountability systems, even the best strategy can be ineffective.

DFIs that invest debt or equity in mature microfinance retail institutions must grapple with the fundamental issue of additionality: Is the DFI providing funds that could not have been raised from other sources? Is it acting as a catalyst for positive change that otherwise would not happen or would have taken longer to achieve?

Microfinance markets and institutions require a broad range of **instruments** (grants, debt, equity, guarantees). However, what matters most is that the instruments are appropriate for the particular task. For example, a funder that focuses on technical assistance to build capacity may not need other instruments beyond grants. A funder that wants to build new microfinance banks may provide equity and debt, in addition to grants, or partner with other funders that have the complementary instruments.

Regional development banks and some multilateral agencies make loans to governments, which can pose challenges when they are used to support microfinance. Incentives in government bodies may be counter to the discipline required for sound management of financial services. The loans may pass through government bodies that do not have strong systems or technical skills to appraise retailers, provide implementation support, and track performance adequately.

The two indicators on **staff capacity** tell a mixed story. While funders, especially DFIs, have increased the number of microfinance specialists on staff, skill-building for nonspecialist staff who work on microfinance can lag. And even microfinance specialists need ongoing professional development as microfinance evolves and the breadth of subspecializations, such as insurance and risk management, increases. In some agencies, specialists are involved only in project design, while staff without specific microfinance expertise are responsible for implementation and supervision. Even the best designed programs and investments may have disappointing results if technical expertise is not brought to bear during implementation and monitoring.

Nearly all of the participating funders scored lowest on indicators that measure **accountability for results**. While most funders can identify their standalone microfinance programs and investments through comprehensive flagging systems, many do not capture microfinance components within larger programs. As a result, these components do not receive the attention of a microfinance specialist. Only a handful of funders systematically collect, analyze, and act on relevant performance indicators for the retail institutions they support. The information may (or may not) be available at the program level, but it is rarely consolidated centrally so that management has a good sense of the overall portfolio performance. Compared to retail support, it is difficult to measure the performance of some programs at the market infrastructure and the policy levels; few funders have made progress in this area. In addition, few funders specify clear performance expectations in their contracts with partners nor do they link disbursements to performance targets.

Learning from past experience requires thoughtful reflection on the overall performance of a funder's portfolio—reflecting on individual project evaluations is not enough. Relatively few funders commission regular independent reviews of their entire microfinance portfolio or significant portions of it.

All these challenges are compounded when funders support partners indirectly, for example through wholesale investment funds or apexes. In such cases, performance-based contracts and performance reporting requirements need to cascade down from the funder to the intermediary to reach the microfinance provider.

Getting to better aid

As a result of their experience with SmartAid, funders are making significant improvements in their systems. Changes range from reorienting strategic focus, upgrading staff skills, and revamping monitoring and evaluation systems. Some funders that participated in 2009 started making changes even before their reports were finalized. As an external assessment tool, SmartAid draws management attention to issues that may have been overlooked and helps identify priorities for change. Preparing documents for SmartAid is a substantial task, but several funders said that the preparation process itself helped to spark lively internal conversations about what works well and what does not.

Beyond helping individual funders improve how they work in microfinance, SmartAid promotes transparency and learning across all types of microfinance funders. By benchmarking

performance among peers, SmartAid promotes a healthy sense of competition and provides incentives to improve. SmartAid also helps funders connect to others that have complementary strengths, thus facilitating collaboration.

SmartAid may also be relevant beyond microfinance. Managers of participating agencies repeatedly say that the lessons from SmartAid can be applied to other development sectors.

In the long run, focusing on internal management systems is not enough. To improve effectiveness, measuring the impact of programs and investments on the ground is also necessary. Taken together, tools that assess internal management systems, such as SmartAid, and tools that measure impact on the ground can provide the impetus—and concrete ideas—to achieve more effective development assistance.

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