



## SMARTAID FOR MICROFINANCE INDEX 2011

### EUROPEAN INVESTMENT BANK (EIB)



## 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.<sup>1</sup>

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.

Six funders— AusAID, EIB, GIZ, KfW, MIF and UNCDF —participated in SmartAid 2011, increasing the total number of funders participating in the SmartAid Index to 18. Prior rounds have included the participation of AECID, AFD, AfDB, AsDB, CIDA, EC, FMO, IFAD, IFC, ILO, SDC, and Sida. Four agencies from the 2011 round have participated in prior SmartAid rounds (GIZ, KfW, MIF, and UNCDF). This diverse group of funders 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.

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<sup>1</sup>See the Better Aid for Access to Finance meeting, 2006: [www.cgap.org/betteraid\\_meeting/compact](http://www.cgap.org/betteraid_meeting/compact).

## Key Findings

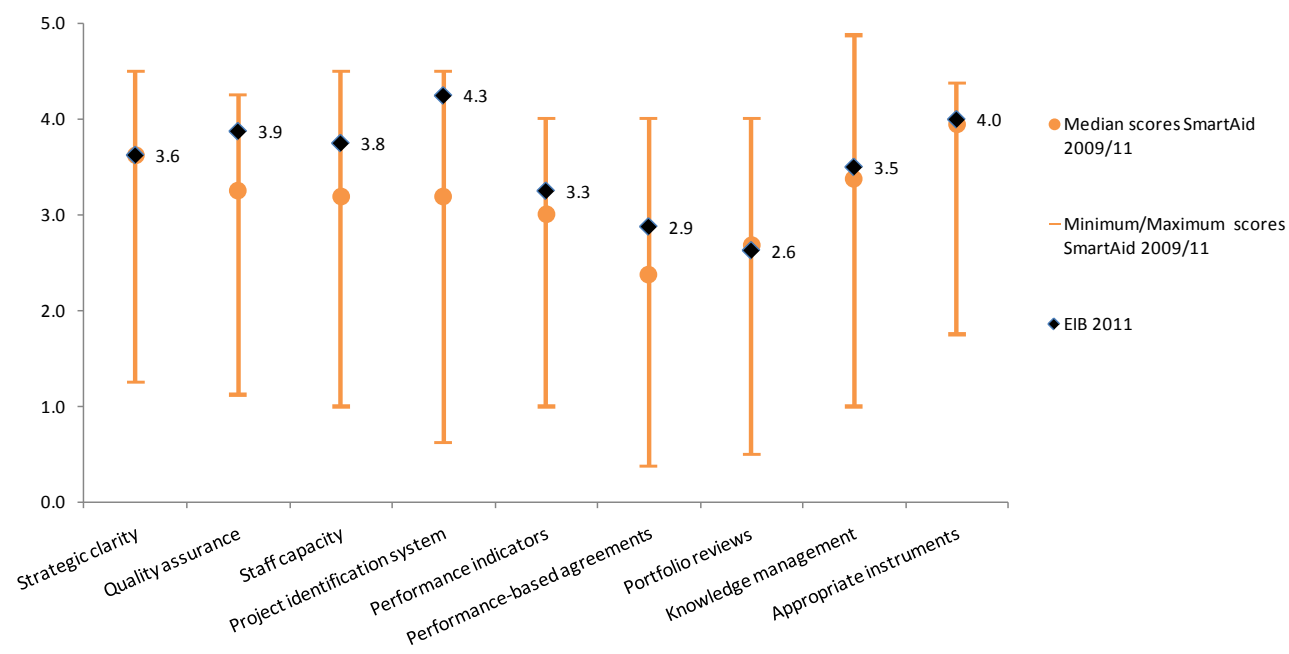
The European Investment Bank (EIB) received 71 out of 100 points, meaning that overall it has “good” systems in place to support microfinance. As the graph below shows, EIB received scores of 4 and higher (on a scale from 0 to 5) on indicators 4 and 9 (project identification system and instruments). Scores were only slightly lower on quality assurance and staff capacity (indicators 2 and 3), and still above 3 on strategic clarity, performance indicators and knowledge management (indicators 1, 5 and 8). EIB’s weakest scores are on two accountability indicators, namely performance-based agreements and portfolio reviews (indicators 6 and 7).

EIB’s microfinance strategy was first articulated in 2004. Since then, EIB’s microfinance portfolio has grown quickly and EIB is now among the 10 largest microfinance funders in terms of commitments.

At a Glance	
Type of funder:	Development finance institution
Microfinance portfolio (committed as of 12/2009):	\$511 million
Microfinance as % of total portfolio:	Less than 1%
Number of projects:	33
Primary level(s) of intervention:	<input checked="" type="checkbox"/> Retail <input type="checkbox"/> Infrastructure <input type="checkbox"/> Policy
Primary instrument(s):	Equity, commercially-priced debt, guarantees
Primary source of funding:	Public funds, private commercially oriented funds

The EIB is the European Union’s (EU) financing institution, and its role is to provide long term financing to support investment projects that are linked to the EU’s policy objectives. EIB’s investments are operated by two directorates: Ops A for operations inside the EU and Ops B for operations outside the EU. Outside the EU, EIB lending is based on EU external cooperation and development policies according to mandates given to the Bank by the European Parliament and the Council of the European Union<sup>2</sup>. Microfinance activities

### EIB Scores



<sup>2</sup> <http://www.eib.org/about/strategy/index.htm>

have been developed under two mandates: the “European Neighbourhood” and the “Development” mandate.

Each operational directorate is organized according to geographical and functional departments and divisions. Microfinance activities are concentrated mainly in two regional departments of Ops B: FEMIP (Facility for Euro-Mediterranean Investment and Partnership) and ACP (Africa, Caribbean and Pacific). The ACP regional department manages an investment facility from which most of EIB’s microfinance activities are funded. The department for Southern European Neighbour and Partner Countries, through the FEMIP risk capital budgetary resources, provides local currency funding directly to microfinance institutions in its target region<sup>3</sup>.

While microfinance is a relatively small segment of its portfolio, EIB has raised awareness about microfinance within the Bank, and its operations can count on solid management backing. As its activities are primarily linked to the Bank’s policy mandates, the Bank does not currently have a harmonized approach for microfinance, but it has made commendable efforts to improve coordination and knowledge sharing across its various divisions through the Microfinance Centre of Expertise (MCE). EIB conducted a SmartAid Self-Assessment in 2009 and started to address many of the issues highlighted during that process.

### Key Strengths and Weaknesses

- **Strategic Clarity (3.6/5.0).** ACP’s strategy on microfinance was updated in 2007 in light of operational results. The strategy is well aligned to good microfinance practices and clearly defines the ACP department’s approach in microfinance and its investment and technical assistance goals. The ACP region is increasingly working through intermediary structures and partnerships with other DFIs and private investors to structure facilities that address sector development needs at the retail level. FEMIP invests directly into MFIs as opportunities to support microfinance via investment intermediaries are limited in its target countries. An EIB-wide harmonized strategy that takes into account the different operational strengths of the departments, while also addressing their respective mandates and market needs, would go a long way to improve EIB’s work in microfinance. The design of the new strategy update for 2011-2013, currently planned only for the ACP department, would be a good opportunity to start formulating a strategy that applies for all EIB’s microfinance investments.
- **Quality Assurance (3.9/5.0).** For the most part, EIB’s internal quality assurance relies on microfinance specialists designing and monitoring microfinance projects. In addition, the EIB’s standard quality assurance systems are strong, with the Management Committee and the Board as ultimate decision making bodies. The operational manual requires that all projects are checked for their additionality, including whether the pricing of loans is market-based. For investments in ACP, the investment facility committee plays an additional quality assurance role. The MCE, while not formally a quality assurance body, does contribute to quality enhancement by serving as a platform to discuss projects among technical specialists of all departments. Despite this relatively strong system of quality assurance, not all projects seem to receive the same amount of attention. For example, EIB’s technical assistance

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<sup>3</sup> Ops A as well as EIF, which is also part of the broader EIB Group, are also active in microfinance. However, the scope of SmartAid was limited to EIB Ops B.

projects do not go through the same rigorous process for approval as investments. Furthermore, the MCE only meets twice or three times a year and there is no mechanism for the MCE to make binding recommendations. While the operational manual instructs staff to conduct checks on market distortions, it is not clear who is ultimately responsible and whether these checks are actually made.

- **Staff Capacity (3.8/5.0).** EIB's microfinance experts are young, dynamic and bring experience from within and outside EIB. EIB offers training and capacity development opportunities for its professionals, both for its microfinance core team and for staff in other departments. Staff were encouraged to participate in the IFBL-ADA microfinance training module, the EC annual training, the CGAP microfinance training and a 2010 CERISE course on responsible finance. EIB is also developing its own in-house microfinance training module. EIB's ability to hire external consultants to evaluate technical assistance projects allows it to leverage its relatively small internal team.
- **Project Identification System (4.3/5.0).** In 2010, after completing the SmartAid self-assessment, EIB added a specific microfinance code to its internal SERAPIS project management system in order to identify all microfinance projects. To enable the correct implementation of this new system, EIB developed clear coding guidelines. The MCE checks compliance and maintains a complete project list. Some manual effort is still required to create a full list of projects as microfinance equity investments in funds and holdings are tracked in a separate database (E-front).
- **Performance Indicators (3.3/5.0).** EIB's standard financial performance monitoring is strong. There is a core set of indicators and a larger set of optional indicators that investment officers can select to incorporate into financing agreements. For example, EIB has an optional indicator focusing on leveraging local capital, which can be used as a proxy to measure additionality. EIB also requires reporting on standard MIX indicators for its own direct investments and follows the CGAP MIV Disclosure Guidelines for reporting from intermediaries. The Bank is looking to make the use of social performance indicators in loan agreements a standard throughout the organization and has already integrated monitoring of Client Protection Principles into its reporting system. EIB also has a strong due diligence checklist which guides investment officers on ratios, documents and other supporting materials needed when conducting due diligence of an investment vehicle/fund. The checklist focuses on the development impact of funds and includes corresponding indicators. While EIB's monitoring system is strong, it lacks refinement for microfinance. Microfinance-specific indicators are considered optional, not core, and therefore there is no standard set of performance indicators to be applied for all microfinance investments. EIB consolidates and reviews financial performance indicators from all investments in its portfolio. While the consolidated analysis of the portfolio through

### Good Practice Highlight

#### Due Diligence Checklist

To ensure that investment officers capture the right information about a potential investee during the due diligence process, the EIB has developed a detailed checklist. The checklist covers analyses of standard documents required of an investee, such as audited financial statements and business plans. But it goes far beyond this and also incorporates evidence on environmental, social and governance related indicators to help EIB select partners that are aligned with its own social and developmental mission.

the MCE updates is very useful, the analysis focuses on amounts disbursed rather than the performance of the underlying investments.

- **Performance-based Agreements (2.9/5.0).** EIB's contracting includes performance-based elements, such as funding in tranches, cost-sharing arrangements, and clearly defined performance milestones. Compliance officers are assigned for each agreement. However, this practice has been introduced only recently, so older projects do not incorporate performance indicators. There is no policy yet that ensures consistency in the use of performance targets and measures for non-compliance. EIB is beginning to consider how to standardize the use of performance-based agreements for microfinance - an excellent first step.
- **Portfolio Reviews (2.6/5.0).** The MCE produces an annual portfolio update that provides information on all microfinance investments and technical assistance projects across EIB. While informative, these updates do not include information on the performance of EIB's investments. Because EIB's microfinance portfolio has only recently reached a significant scale, there has been no performance review across the entire portfolio so far. Given the continued growth of the microfinance portfolio, EIB would benefit from regular portfolio reviews that extract learning from past performance and that can guide its future growth and strategy. The recently commissioned midterm evaluation of the technical assistance support to microfinance in Sub-Saharan Africa is an excellent move in this direction.
- **Knowledge Management (3.5/5.0).** The establishment of the MCE in 2008 was an excellent step to facilitate knowledge and learning across the various divisions in the Bank. The MCE meets twice a year and provides a forum to discuss projects in the pipeline across the Bank and exchange lessons learned at the project level. The MCE's role as a knowledge-hub has been endorsed by management and the MCE now has its own dedicated webspace for microfinance. The secretariat function of the MCE rotates among EIB departments and EIF which can be a useful impetus for knowledge sharing, but the MCE does not have specifically assigned staff. The SERAPIS system serves as a repository of information on projects which can be accessed by staff, but the information and data tracked and shared to date do not include analyses of performance of outstanding projects or lessons learned. More knowledge sharing along those lines will help to create more dynamism and could guide future strategic responsiveness in the microfinance portfolio. Individual job descriptions include knowledge management as part of the responsibilities. However, there is no dedicated budget for knowledge management which could reduce the incentives for a focus on this issue.
- **Appropriate Instruments (4.0/5.0).** EIB has a full range of instruments, with thorough and clear procedures, that correspond well to its mandates. It has tools in place to help its investment officers assess the additionality of their projects, it has safeguards against crowding out of the private sector and it seriously explores exit options for its equity investments. EIB collaborates well with the private sector and other institutional funders, complementing its own strengths with those of others. EIB's investments aim to leverage private funds and the Bank allocates staff and resources for participation on board seats of various Microfinance Investment Intermediaries (MIIs) and some MFIs. However, some additional reflection and internal checks are needed to ensure additionality of some of its operations.

## Recommendations

EIB has made very steady progress in becoming an effective and responsible funder in microfinance. As its portfolio has grown, EIB has developed internal systems proportionate to this growth, which allow it to manage and support its microfinance investments and technical assistance projects. Most notably, EIB has invested in its staff capacity, created knowledge management functions and established a clear microfinance project identification system. With a strong core team now in place and with the MCE as a platform for institutional learning, the EIB is well positioned to build on the progress it has already made.

The following suggestions emerge from the SmartAid review:

- **Develop operational strategy for the Bank as a whole.** EIB's microfinance operations fall under different mandates. While this might make institutional harmonization more difficult, it should not impede harmonization at the strategic level. EIB's microfinance strategy should be developed for the Bank as a whole, taking into account its various divisions, their mandates and their internal strengths and weaknesses.
- **Create a secretariat for the MCE with its own resources.** Until early 2011, MCE was managed by the ACP department, although no additional human resources were allocated for this function. The MCE has added tremendous value to the work of EIB to date and this should be further encouraged. To fully serve its knowledge, learning and quality enhancement functions, the MCE also needs core resources. While the rotation of the MCE secretariat is a good way to strengthen microfinance capacity in all departments, the function should be supported by dedicated staff time and a budget for training, knowledge-sharing activities, and other events. The MCE should continue to develop creative knowledge sharing tools such as brown bag lunches, learning months, and case studies and should also consider meeting more regularly to consolidate and reinforce learning across the organization.
- **Increase staff capacity throughout the Bank.** EIB's culture is clearly supportive of staff development and learning. EIB should focus more effort to ensure that staff capacity in microfinance is improved throughout the Bank and that there is a common understanding of the risks and opportunities involved in microfinance investments. Incentives to participate in training or short secondments with other divisions may be some options to consider.
- **Improve system for performance monitoring.** EIB's SERAPIS system is able to store project documents and information, but does not yet have the capacity to serve as a database for performance monitoring. Thus to analyze performance information throughout the portfolio, EIB has to manually consolidate information from individual monitoring reports. Firstly, EIB should establish a core set of standard indicators on which all projects (both investments and technical assistance) must report, and these indicators should capture the performance of the underlying investees<sup>4</sup>. Secondly, EIB should either adapt SERAPIS or develop a simple performance monitoring system that allows it to store and consolidate performance information. Data should be consolidated regularly for use within divisions as

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<sup>4</sup> See CGAP (2009). Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track. <http://www.cgap.org/p/site/c/template.rc/1.9.36551/>

well as to compare performance across divisions and mandates to extract lessons as guidance for future funding decisions. An adequately staffed MCE could be charged with this responsibility.

- **Conduct a portfolio review.** EIB's portfolio in microfinance has grown in the past several years and now warrants deeper analysis of what is working, why, and what could be improved. Understanding performance to inform future project design is a hallmark of a learning organization. A portfolio review should analyze all microfinance projects or an important sub-section of the portfolio. It should look at underlying performance information of the institutions in which EIB is investing, whether directly or indirectly via intermediaries. In addition, the portfolio review should analyze EIB's own inputs and value added, the projects' attainment of their objectives and thus draw lessons learned on comparative strengths and weaknesses. This type of review should be shared widely within the EIB.
- **Standardize use of performance-based agreements and include social performance indicators.** EIB already incorporates several key performance-based elements into its agreements, but does not have clear performance targets or thresholds. It is now requiring its intermediaries to use performance based-agreements with the MFIs in which they invest. For its own loans and technical assistance agreements, EIB can do more to make these agreements reward good performance by setting clear targets for performance along a set of core indicators. It can also articulate clear measures for non-compliance should performance fall short of targets. One or more of these indicators should be measuring social performance, given EIB's strategy and focus on social performance.

## Methodology

SmartAid distills learning from over nine 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.


The nine indicators used in the SmartAid Index were selected and refined over the course of a pilot round in 2007, an external evaluation, consultation with experts and the first round of the Index in 2009. For the 2011 round two of the indicators were further refined to remove redundancy, however the indicators remain consistent in nature and scores are comparable across the 2009 and 2011 rounds. The scores of the 2007 pilot round are not comparable.

The nine 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. Medians as well as minimum and maximum scores shown in the graph in the Key Findings section represent the scores of all participants of the 2009 and 2011 SmartAid rounds. For agencies participating in more than one round, only their latest score is included in the medians.

Naturally, a margin of error is unavoidable in this type 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.

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

<b>SmartAid for Microfinance Index Indicators</b>			
<b>Strategic Clarity</b>	<b>1</b>	Funder has a policy and strategy that addresses microfinance, is in line with good practice, and is based on its capabilities and constraints.	<b>15 points</b>
<b>Staff Capacity</b>	<b>2</b>	Funder has quality assurance systems in place to support microfinance projects and investments.	<b>10 points</b>
	<b>3</b>	Funder has the staff capacity required to deliver on its microfinance strategy.	<b>15 points</b>
<b>Accountability for Results</b>	<b>4</b>	Funder has a system in place that identifies all microfinance projects and components.	<b>10 points</b>
	<b>5</b>	Funder monitors and analyzes performance indicators for microfinance projects and investments.	<b>10 points</b>
	<b>6</b>	Funder incorporates performance-based elements in standard agreements with partners.	<b>10 points</b>
	<b>7</b>	Funder regularly reviews the performance of its microfinance portfolio.	<b>10 points</b>
<b>Knowledge Management</b>	<b>8</b>	Funder has systems and resources for active knowledge management for microfinance.	<b>10 points</b>
<b>Appropriate Instruments</b>	<b>9</b>	Funder has appropriate instrument(s) to support the development of local financial markets.	<b>10 points</b>
<b>MAXIMUM SCORE</b>			<b>100 points</b>

## 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.

## Funders participating in SmartAid to date

Agencia Española de Cooperación Internacional para el Desarrollo (AECID), Agence Française de Développement (AFD), African Development Bank (AfDB), Asian Development Bank (AsDB), Australian Agency for International Development (AusAID), Canadian International Development Agency (CIDA), European Commission (EC), European Investment Bank (EIB), FMO, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), International Fund for Agricultural Development (IFAD), KfW Entwicklungsbank (KfW), International Finance Corporation (IFC), International Labour Organization (ILO), Multilateral Investment Fund (MIF), Swedish International Development Cooperation Agency (Sida), Swiss Agency for Development and Cooperation (SDC), United Nations Capital Development Fund (UNCDF)

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