

Swedish International Development Cooperation (Sida) Letter to Management

Executive Summary

A team comprising David Stanton of DFID, Richard Roberts of FAO, and Brigit Helms and Alexia Latortue of CGAP conducted a Donor Peer Review of Sida in Stockholm from 20-24 May, 2002. The review is part of a 21-agency initiative launched by UK Secretary of State Clare Short and CGAP to concretely tackle aid effectiveness by using microfinance as a test case.

The Peer Review team focused on the internal procedures, practices and processes of Sida to identify the success factors and constraints that influence the effectiveness of the agency's microfinance operations. The microfinance specialists within INEC provided the team with an orientation to Sida and organized meetings with over 35 staff members, including regional and sector departments and embassies. The team briefed the Director General and other members of the management team on its initial findings on May 24.

The Peer Review team found its visit to be timely given the current process underway at Sida to develop a new policy, operational guidelines, and tools in microfinance. The team hopes that this letter to management will enrich the internal discussions and provide specific ideas of how Sida can improve the effectiveness of its microfinance operations.

This letter outlines Sida's strengths and challenges, and presents a number of specific recommendations for change. A matrix at the end of the letter provides a summary of the key findings and recommendations organized around six strategic areas.

The recommendations address the need to clarify Sida's role and comparative advantage in microfinance. The team's suggested actions for change fall into four main categories:

- ***Achieve Strategic Clarity.*** Sida should clarify internally the cross-cutting contribution of microfinance to its development agenda and install incentives to follow sound practices.
- ***Improve Accountability for Results.*** Sida should more systematically employ performance-based contracts, monitor performance against targets, and define exit strategies at the outset of program design in microfinance.
- ***Enhance Technical Capacity in Microfinance.*** Sida should increase the number of staff specialists in Stockholm (decentralization needs a strong center), while recruiting local staff in selected countries with some microfinance expertise.
- ***Clarify Role of the Stockholm-based Microfinance Unit.*** Assuming a commitment to improving its overall technical capacity in microfinance, Sida should define four roles for the central unit: non-specialist training, helpdesk function, knowledge management, and resource leverage.

Background

Early in 2002, CGAP and DFID's Secretary of State Clare Short launched an initiative to improve aid effectiveness, using microfinance as a test case. As a first step in this initiative, more than 20 bilateral and multilateral development assistance agencies have volunteered to participate in a series of Donor Peer Reviews. These Peer Reviews are not evaluations or detailed portfolio reviews, but rather focus on each agency's internal procedures, processes, practices and systems to identify success factors and constraints to good practices in microfinance.

The short but intensive reviews will result in concrete recommendations for each agency and should lead to senior management commitment to specific changes that improve the effectiveness of microfinance operations. It is expected that the analysis and recommendations may also apply to other areas of development assistance pursued by each agency.

A Peer Review team including David Stanton, Chief Enterprise Development Advisor of DFID, and Richard Roberts, recently retired Chief of the Marketing and Rural Finance Service, Agricultural Support Systems Division of FAO, visited Sida headquarters from 20-24 May, 2002. The team was accompanied by Brigit Helms and Alexia Latortue of the CGAP Secretariat. The review team interviewed more than 35 Sida staff members from a wide range of departments, including regional and sector departments (INEC, NATUR and SEKA), and embassies. In addition, a field visit to Uganda was conducted from 29 April-3 May 2002.

The Peer Review team's findings for Sida, contained in this letter to management, will be combined with those from other agencies in a synthesis report. The overall results and specific follow-up actions will be discussed in a meeting hosted by Clare Short in Rabat, Morocco on 9 September, 2002. A final meeting of Ministers and heads of agencies participating in the peer reviews will be organized upon completion of all the reviews in 2003 to share experiences and changes made as a result of the exercise.

This letter to management outlines Sida's strengths and challenges with respect to applying good practices in microfinance. It then presents a number of specific recommendations for change. Finally, a summary matrix presents the key findings and recommendations according to six analytical areas.

Sida's Strengths

The overall goal of Swedish development cooperation has consistently remained that expressed by its Parliament in 1962, "improving the quality of life of poor people." Sida recognizes the multiple dimensions of poverty and combats it on several fronts—economic, social, and democratic. All of Sida's work is guided by a deep belief that freedom from poverty is a human right, and that the poor should be empowered to be agents of their own change.

Against the backdrop of this consistent and coherent vision of Sida's approach to development assistance, the Peer Review team noted several changes and trends in the overall Swedish Development Cooperation. The majority of the trends represent significant opportunities for Sida's work in microfinance: decentralization of funds and decision-making to embassies; increased interest in defining the role of the private sector in development; and continued focus on Africa. Another trend, the increased volumes of funds, should be managed carefully to ensure that disbursement pressure does not compromise quality or interest in relatively small, but high-impact projects.

The elements of Sida's strengths related to microfinance follow:

- Responsiveness to the needs of poor clients by staying close to the ground and developing programmes through community-level, participatory approaches rather than by direction exclusively from the top. This approach is consistent with new directions in microfinance that give priority to financial services that respond to client needs rather than more supply-driven models.
- Explicit coordination with other donors and development partners leverages resources, reduces transactions costs to recipient governments, and builds on donors' comparative advantage. Sida's recent decision to add its funds to GTZ's existing Financial Sector Development Programme in Uganda is a good example.
- Sida's commitment to sustainability and long-term partnerships provides the opportunity for sound institutional development, leading to permanent financial services for the poor.
- Sida's innovative work in housing finance has led to the agency's specialist expertise in this sector, where few other donors are active.
- Sida's culture of openness, flexibility and learning, and its flat organizational structure encourage initiative and creativity. This organizational culture also enables staff to adapt projects to changing priorities or needs, encouraging the incorporation of new ideas and strategies in mid-course.
- Technical advice provided by the microfinance specialist has had a very positive impact on the quality of design of both financial services components and stand-alone microfinance projects. This expert advice has engendered among Sida staff a general understanding of the importance of working through existing specialized institutions in the provision of financial services.

Sida Challenges

Notwithstanding its promising environment for microfinance, Sida faces a number of constraints to maximizing its effectiveness in this area:

- There is a lack of clarity on what microfinance is and how it relates to Sida's overall development goals and approach to poverty reduction. Specifically, Sida staff expressed divergent views on whether and how microfinance fits in to Sida's perspective on the multidimensional aspects of poverty, and its dual emphasis on poverty reduction and growth. Staff views range from seeing microfinance as an input to further other objectives (i.e. housing, agriculture), a means toward permanent provision of financial services to poor people, or a response to poverty reduction that might not be the most cost-effective alternative.
- As in other agencies and across the microfinance industry, Sida struggles with poor quality credit components within larger, integrated projects such as rural development or housing. Much of the difficulty arises from confusion over the goals of the project: targeting specific client groups for poverty lending, versus the building of sustainable financial institutions. Finding appropriate implementing agencies with whom to build long-term partnerships also presents a big challenge.
- While offering many benefits as noted above, some positive aspects of Sida's organizational culture (taking a long-term perspective; freedom of individual initiative; and a deep sense of ownership of projects by staff members) also pose a risk to quality microfinance programming. Sida staff often have difficulty closing projects down. Quality control is sometimes inadequate, and resistance to outside views among the staff who helped find, design and monitor projects can mitigate against the introduction of good practices in microfinance. Sida's microfinance projects and credit components do not typically include either performance-based targets or exit strategies.
- The overall trend in Sida toward increasing programme budgets without a corresponding increase in staff might intensify internal pressure to formulate and implement larger projects. However, microfinance is not an area where large amounts of grant money should be spent, even though intensive technical inputs are usually necessary for success.
- The demand in Sida for expert microfinance advisory services clearly exceeds supply. With only one permanent full-time person, the Stockholm-based microfinance team is overwhelmed by demand from the rural development department, the urban development division, and the embassies. The quality of services provided is uniformly praised, but staff repeatedly stress the need for additional services beyond input in project design and crisis management. The implementation of the field vision (decentralization) will almost certainly place extra strain on the already overstretched central resource.
- The precise role of the Stockholm-based microfinance team remains unclear. Who are its clients? Should it be proactive, or reactive? Should it manage its own project portfolio or should it act purely as an internal service center? Should it provide direct training services, or merely coordinate such events? What is its responsibility for knowledge management?

- Sida’s heavy reliance on consultants poses the risks of losing institutional knowledge and learning, de-skilling of staff and inconsistent quality control. While Sida uses consultants effectively to relieve overstretched staff and obtain specialized skills, many staff believe that certain core tasks should not be outsourced.
- Technical inputs on credit components of multi-sector projects tend to occur in an *ad-hoc* fashion. There is no pre-defined structure to ensure appropriate technical involvement in project design. It is left to individuals to contact the microfinance team, but sometimes these individuals have insufficient knowledge to be able to specify the type of help required.
- Microfinance is not particularly “visible” to Sida’s important Project Committee nor to its departmental review committees, which are established to approve projects. As a result, these committees might, in the absence of guidance, overlook the credit components. Yet, these committees are correctly regarded by Sida staff as being an essential quality assurance mechanism in the project cycle.
- There is general consensus among Sida staff that a more structured approach to project monitoring could be beneficial. In the case of microfinance, limited monitoring or post-investment follow-up restrict the availability of information on portfolio quality, compromising the agency’s ability to learn from experience.
- Sida needs to enhance knowledge transfer between its microfinance specialists and its generalists as well as between its staff in headquarters and in the field. The lack of information and knowledge sharing is likely to intensify as Sida further decentralizes its activities to embassies.

Recommendations

The Peer Review team has the following recommendations to build on Sida’s strengths, and to improve its effectiveness in microfinance.

- 1) Sida needs **sharper strategic clarity** on the key cross-cutting contribution of microfinance to the agency’s overall development goals. This clarity could be achieved through five inter-related activities:
 - *Communicate commitment at high level.* The Director General should communicate how microfinance contributes to Sida’s overarching goals. This high-level signal will help to focus staff attention on improving quality in this area of programming.
 - *Embed microfinance in the private sector.* Notwithstanding its cross-cutting nature, it is important for Sida to continue to embed microfinance both conceptually and structurally within a financial systems and market-oriented perspective. A business emphasis is crucial to underline the goal of assuring permanent access to financial services for poor people. This should also help ensure that financial services components are correctly used in support of worthwhile investments, and not simply

as incentives to ensure participation by the target “project beneficiaries.” Sida should also develop a transition plan to handle on-going projects that do not adhere to these business principles.

- *Accompany policies with practical “what works” guidelines.* Although Sida’s efforts to formulate private sector development and microfinance policies are to be encouraged, the Peer Review team found limited appetite among staff for “yet another policy.” The microfinance policy needs to be accompanied by practical, operational guidelines on microfinance, with a focus on brief 2-3 page “what works” documents that can be easily understood and used by non-specialist staff.
- *Integrate incentives into existing structures.* Given Sida’s organizational culture, it is inappropriate to require all programme managers to obtain specialist advice on all credit components. However, the team notes that this specialist advice has greatly improved the quality of project design where it has been obtained. Therefore, the team recommends that the new version of “*Sida at Work*” includes a few basic questions for the Project Committee and the departmental review committees to safeguard quality in financial services components of larger projects. This mechanism will provide an incentive for staff to seek specialist advice. Examples of questions that could be included are: “Does the credit component plan to work with existing, specialist institutions (as opposed to government ministries or other non-specialist organizations)?” or “What evidence is there of cost recovery and financial sustainability in the project over time?”
- *Consider specialization in “niche” markets.* Given Sida’s limited resources, accumulated expertise and current portfolio in microfinance, Sida might consider specializing in housing finance and rural finance with an emphasis on contributing to increased international learning in these two areas. Sida might also look into co-financing stand-alone microfinance projects and selected industry infrastructure projects (capacity-building, policy work, etc.). These types of programs would also take advantage of Sida’s flexible grant instrument and operating style.

2) Sida could strengthen its microfinance operations by **improving accountability for results.**

- *Incorporate performance-based contracts.* It is desirable for microfinance projects or financial services components of projects to include performance-based milestones, with additional funding being released only upon achievement of clearly defined targets. This trend has already begun at Sida and should be encouraged and mainstreamed.
- *Monitor performance against targets.* Performance-based contracts must be accompanied by rigorous monitoring of performance against expectations, and training of selected staff to provide a basic minimum knowledge on how to interpret and act upon the monitoring reports.
- *Define an exit strategy from the start.* A final element of the performance-based approach entails a clear exit strategy. Good microfinance services should eventually become financially sustainable – i.e. completely free from subsidies. This requires that Sida’s exit strategy be built into each project design from the very beginning.

- 3) Sida should enhance its **technical capacity** in microfinance, both in Stockholm and in the embassies.
- *Increase technical staff capacity in Stockholm.* Decentralization needs a strong center. Sida should increase its microfinance staff complement to three full-time specialists in INEC/FINANS, to be shared with urban and rural development departments as appropriate. Stockholm should also provide a helpdesk function. Depending on how Sida chooses to specialize, particular areas of competence—such as experience in rural and housing finance—should be sought in the recruitment process.
 - *Recruit local expertise for embassies.* At embassy level, it is recommended that Sida recruits staff with some specialist microfinance skills in key selected countries where this area of programming is most intensive. Locally-recruited staff could possibly serve as regional resources as well.
- 4) Assuming a commitment to enhance overall technical capacity in microfinance in Sida, the **role of the microfinance unit** should be clarified. The Peer Review team identified four key functions: training of non-specialists, helpdesk, knowledge management, and leveraging resources. Depending on the resources available, the unit may face a trade-off in fulfilling these key internal functions and staying involved in direct project management.

Training of non-specialists. The microfinance unit has proved that it can raise the overall level of technical competence through a programme of orientation and training of staff both at the sector level (urban and rural, specifically) and in the embassies. The primary goal of more systematic training in the future is to ensure that programme managers act as “intelligent customers” of technical assistance, and know when to seek expert advice.

Helpdesk. Much of the microfinance unit’s existing work can be defined as a helpdesk function, i.e. supporting project design and managing short-term technical needs as they arise. The envisioned helpdesk function would be made more proactive and comprehensive, including “hands-on” practical advice, and a more systematic support in the formulation of country strategies, project origination and design and monitoring. For reasons of accessibility and knowledge management, the bulk of the helpdesk function should be internal, that is, the responsibility of the microfinance unit staff. Specific tasks and/or areas of technical expertise, however, could be outsourced.

Knowledge management. The central microfinance unit has an important role to play in ensuring information and knowledge sharing about both internal and external practices. The goal is to launch a process of evidence-based learning that assimilates actual project experience and feeds back more effectively into Sida policies and practices across sectors and regions. One important dimension of knowledge management is to integrate microfinance indicators into the framework of Sida’s ongoing rating project, which seeks to track project performance more systematically.

Leverage. As competent as Sida staff may be, they cannot do it all on their own. The central microfinance unit should help link programme managers to external resources, consultants, other donors, and to CGAP members and its Secretariat. For reasons of ease of access and cost-effectiveness, Sida should take more advantage of the Nordic market of consultants when looking for international consultants. In addition, Sida should consider closer engagement with the Swedish NGOs involved in microfinance. Although these links already occur successfully in some places, they could be more systematically pursued.

AID EFFECTIVENESS AND MICROFINANCE MATRIX -- Swedish International Development Cooperation (Sida)

		Analysis	Recommendations
1.	Strategic Clarity and Organizational Culture	<ul style="list-style-type: none"> • Clear institutional focus on democratic and rights-based development is consistent with microfinance principles • Lack of clarity on the role of microfinance within the broader development agenda • Commitment to sustainability and long-term perspective to development • Corporate culture of openness, flexibility, personal initiative, and learning in a very flat organizational structure poses both opportunities (innovation and commitment) and potential risks (difficulty closing down projects, insufficient quality control) • Relatively low appetite for new policies or “rules” 	<ul style="list-style-type: none"> • Communicate microfinance as a cross-cutting contribution to Sida’s goals from the highest levels • Complement forthcoming private sector and microfinance policies with concrete, “what works ” operational guidelines • Develop a plan for transitioning Sida’s current microfinance portfolio to be in line with the new more market/PSD approach to supporting microfinance
2.	Technical Expertise & Resources	<ul style="list-style-type: none"> • Under-resourced but highly effective technical expertise – demand for technical advice exceeds supply • Positive impact of technical expertise on the quality of project design • Over-reliance on consultants poses risks of staff deskilling and poor knowledge management • Building up expertise in housing finance 	<ul style="list-style-type: none"> • Increase core technical team to three full-time specialists in INEC/FINANS, to be shared across other sectors • Recruit local specialists at embassy level in select countries based on extent of microfinance portfolio • Encourage and facilitate locally-recruited specialists to play a regional advisory role
3.	Organizational Structure and Flows	<ul style="list-style-type: none"> • Microfinance specialists are placed in the financial sector department • Lack of clarity regarding the role of the Stockholm-based microfinance team • Field vision (decentralization) will intensify the challenges to the central unit to maintain quality control 	<ul style="list-style-type: none"> • Continue to embed microfinance in financial systems and market-oriented disciplines • Clarify the role of the central microfinance unit • Involve central unit in recruitment decisions for specialized local staff • Intensify training of non-specialist staff to raise awareness and stimulate increased demand for

		<ul style="list-style-type: none"> • Limited knowledge exchange between microfinance specialists and generalists and between Stockholm and field operations • Explicit coordination with other donors and partners 	<p>technical advice</p> <ul style="list-style-type: none"> • Introduce a formal “helpdesk” function (which core activities should be located in-house though certain tasks and areas of expertise could be outsourced) for advice throughout the project cycle • Enhance knowledge management function, both internally and externally • Increase leverage through working with other donors and partners
4.	Instruments and Incentives	<ul style="list-style-type: none"> • Difficult to ensure quality of credit components in multi-activity projects (rural and urban), mainly due to confusion over project goals • Trend toward increasing programme budget while holding staffing levels constant may increase disbursement pressure 	<ul style="list-style-type: none"> • Reinforce trend towards selecting specialist implementing partners for financial services components • Increase use of performance-based contracts which hold partners accountable for results, and make extra funding conditional upon meeting targets • Ensure an exit strategy in all financial support contracts
5.	Project Cycle	<ul style="list-style-type: none"> • Ad hoc technical inputs into design of credit components in multi-sector projects • Important Project Committee and departmental technical approval committees not focused on microfinance • Weak project monitoring and knowledge management 	<ul style="list-style-type: none"> • Integrate questions about microfinance into Project Committee and departmental review committee guidance via the updated “Sida at Work” publication • Improve monitoring of microfinance projects by integrating simple performance targets into the new Sida project rating system
6.	Future Microfinance Operations	<ul style="list-style-type: none"> • Trend toward better practices in urban projects, and avoiding credit components in rural projects 	<ul style="list-style-type: none"> • Consider specializing in housing finance, rural finance, co-financing stand-alone microfinance projects with other donors, and selected industry infrastructure programs to leverage limited resources, flexible instruments, and agile operational style

