SmartAid for Microfinance Index 2013

Submission Guide

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Foreword

Financial inclusion has attracted an increasingly diverse range of funders, both public and private, ranging from bilateral and multilateral donors to private foundations and socially responsible investors. The entry of new players has resulted in a greater scrutiny of how public funders spend their resources and demand for more accountability for results. Through the SmartAid for Microfinance Index, CGAP's members submit themselves to rigorous review, and engage in self-examination to improve their practices, in the common understanding that their work is to build self-sustaining markets for financial services for the poor.

The SmartAid for Microfinance Index is now in its fourth round. Eighteen funders have participated in SmartAid to date, representing around 60 percent of total commitments to microfinance. Of these funders, four have participated in SmartAid in multiple rounds, each time demonstrating significant improvements in performance. SmartAid has proven to be useful as an evaluation instrument for funders, and it has resulted in significant internal changes for many participating agencies.

Funders participating in SmartAid should be highly commended for their transparency, accountability, and deep commitment to continual improvement and learning. When accompanied by other evaluation tools, such as portfolio reviews and impact studies, funders can use the learning from SmartAid to re-assess their strategy for financial inclusion and to refine their value addition to the industry's shared vision for attaining full financial inclusion.

This Submission Guide leads participating funders through the submission process. It explains the rationale behind the indicators and describes what the SmartAid Review Board looks for when assigning scores. Of course, CGAP is available throughout the process to make SmartAid a valuable experience for all participating institutions.

Funders interested in SmartAid can contact Mayada El-Zoghbi (melzoghbi@worldbank.org) or Barbara Gähwiler (bgahwiler@worldbank.org) for further information.

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I. SmartAid for Microfinance Index: A Brief Overview

The SmartAid for Microfinance Index (SmartAid) measures whether funders are set up to support microfinance effectively. Measuring the effectiveness of funding for microfinance is not easy, given the long chain from project conception, to implementation on the ground, to impact on the lives of the poor. SmartAid focuses on the first part of this chain, funders' internal management systems, with the simple premise that funders with strong systems are more likely to support better projects on the ground. SmartAid does not evaluate the on-the-ground performance of funders' microfinance portfolios; other tools (e.g., portfolio reviews) exist for that purpose.

In 2006, 29 major development institutions[1] asked CGAP to create a tool that would help them improve the effectiveness of their support to microfinance. In response, CGAP developed SmartAid. Many factors that affect project performance are beyond funders' influence, but SmartAid focuses on those factors that funders can have more direct control of—their internal systems. Effective internal systems are a necessary, although not sufficient, condition for successful projects and investments.

Today, many funders are subscribing to a broader vision of financial inclusion that goes beyond microfinance. Financial inclusion is the state in which all individuals and businesses have the choice to access and the ability to use a wide range of appropriate financial services, responsibly provided by institutions permitted to offer such services. The SmartAid for Microfinance Index takes this evolution into account, requiring funders to have strategies and policies in place that are conducive to the development of local financial services markets and responsive to changes in the funding landscape. However, the SmartAid for Microfinance Index does not judge funders' strategic choices within this vision of financial inclusion. Whatever target group, level of intervention, or region a funder chooses to focus on, SmartAid assesses whether the systems are in place to implement a given strategy effectively. In this guide, the term "microfinance" refers to the broader vision of "financial inclusion," therefore, we use both terms interchangeably.

[1]See www.cgap.org/betteraid_meeting/compact for more information.

What does SmartAid offer funders?

SmartAid is a service for funders that want to improve their effectiveness in supporting financial inclusion. Participating funders receive an independent external assessment of how they work based on an established methodology that builds on CGAP's work in aid effectiveness over the past decade.

Funders benefit most from SmartAid when they have a broad internal interest and commitment, including from senior management, to participating in SmartAid, because they want to learn and take actions to improve internal processes and practices. An important component of the SmartAid process are the built in opportunities for in-depth discussions between staff and management that bring together different departments that work on microfinance. Participants receive a concise, customized report that includes a score, an analysis of strengths and weaknesses, and a discussion of concrete recommendations that will help them set priorities and facilitate internal change. A CGAP team of experts is also available to support funders in developing an action plan to implement the recommendations.

By participating in SmartAid, funders demonstrate their commitment to transparency and accountability, which sends a strong signal to partners, stakeholders, and other funders active in microfinance. SmartAid can also help funders understand where they stand relative to other donors and investors, providing ways to find synergies and opportunities for collaboration with other organizations by identifying areas of common interest and comparative advantage. SmartAid is intended to create momentum for individual and collective improvement so that financial inclusion lives up to its promise of improving poor people's lives.

Funders are strongly encouraged to share their SmartAid reports openly, but publication is not mandatory and the documents submitted by funders are considered confidential.

Who participates in SmartAid?

SmartAid is offered every two years. It is open to all types of donors and investors that support financial inclusion. Past SmartAid participants include development finance institutions (DFIs), multilateral development agencies, regional development banks, and bilateral agencies using different instruments, such as grants, debt and equity investments, or loans to governments.

Experience shows that SmartAid can be a useful tool for all types of donors and investors. Though the same indicators are applied to all types of funders, good performance can take different forms at different institutions. Size, level of centralization, staffing model, and strategy all affect the kinds of systems needed. SmartAid pays due attention to these differences, taking into account the coherence between a funder's organizational

structure and its internal management systems. When scoring a funder's submission, the Review Board looks at what systems are needed given a funder's institutional set up.

Seven funders participated in the pilot round of SmartAid in 2007; 11 funders participated in SmartAid in 2009, and six funders participated in 2011. These previous SmartAid participants represent the major funders in microfinance. Funding committed to microfinance by SmartAid participants accounted for $9.4 billion as of December 2009.[2] Although changing internal systems takes time, the results from past SmartAid rounds are translating into concrete improvements.[3] Funders that participated in SmartAid repeatedly demonstrated improvements over time.

SmartAid 2007 participants

AsDB, CIDA, FMO, GTZ, KfW, Sida, UNCDF

SmartAid 2009 participants

AECID, AFD, AfDB, EC, GTZ, IFAD, IFC, ILO, MIF, SDC, UNCDF

SmartAid 2011 participants

AusAID, EIB, GIZ, KfW, MIF, UNCDF

For more information on SmartAid, the results from the last round, and funders' SmartAid reports, visit www.cgap.org/funders.

II. SmartAid Methodology

The SmartAid methodology is based on CGAP's collaboration with a broad range of funders as well as consultations with experts on indices and aid effectiveness more broadly. The methodology builds on the findings of 17 Microfinance Donor Peer Reviews facilitated by CGAP from 2002 to 2004. From this work, five elements emerged as critical for the effectiveness of funders' internal management systems.

- **Strategic clarity:** Does a funder have an agency-wide vision for microfinance and are its policy and strategy aligned with good practice and based on its capabilities and constraints?
- **Staff capacity:** Does a funder have staff with relevant expertise to operationalize its strategy and ensure the quality of its microfinance projects and investments?

[2]2010 CGAP Microfinance Funder Survey.
[3]Funders that participated the pilot round share how SmartAid helped catalyze change within their institution in the SmartAid Change Stories at http://www.cgap.org/p/site/c/template.rc/1.11.7956/1.26.11117/

- **Accountability for results:** Does a funder have systems in place that ensure the adequate monitoring and performance-based management of microfinance projects and investments?
- **Knowledge management:** Does a funder have systems and resources to create, disseminate, and incorporate learning from its own and others' experience?
- **Appropriate instruments:** Does a funder have instruments that are used in a flexible manner and adapted to market needs?

With the help of CGAP's members, advisers (including the Center for Global Development), and microfinance experts, these five elements were translated into a set of indicators that constitute the SmartAid for Microfinance Index.

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 points**
Staff Capacity	**2**	Funder has quality assurance systems in place to support microfinance projects and investments.	**10 points**
	3	Funder has the staff capacity required to deliver on its microfinance strategy.	**15 points**
Accountability for Results	**4**	Funder has a system in place that identifies all microfinance projects and components.	**10 points**
	5	Funder monitors and analyzes performance indicators for microfinance projects and investments.	**10 points**
	6	Funder incorporates performance-based elements in standard agreements with partners.	**10 points**
	7	Funder regularly reviews the performance of its microfinance portfolio.	**10 points**
Knowledge Management	**8**	Funder has systems and resources for active knowledge management for microfinance.	**10 points**
Appropriate Instruments	**9**	Funder has appropriate instrument(s) to support the development of local financial markets.	**10 points**
MAXIMUM SCORE			**100 points**

Different weights are assigned to the five elements of effectiveness, giving due prominence to those that have a systemic impact on how a funder works in microfinance. Accountability for results accounts for 40 percent of the total score, followed by staff capacity (25 percent), strategic clarity (15 percent), and knowledge management and appropriate instruments (10 percent each). Individual indicators each represent either 10 percent or 15 percent of the maximum score of 100 points.

Participants are asked to submit documents that show their performance on each of the nine SmartAid indicators. The submissions are reviewed by the SmartAid Review Board, a committee of four microfinance specialists with extensive expertise and experience

working with a broad range of funders. Each Review Board member independently scores funders against all indicators; final scores are agreed upon in a joint meeting.

Participating funders receive a score from 1 to 5 for each indicator. A score of 1 stands for inadequate performance; a score of 5 means that the funder provides an example of good practice for the indicator. The scores are weighted and added up; the maximum score is a total of 100 points.[4] CGAP's findings are communicated to each funder in a concise, customized report that includes a detailed analysis of strengths and weaknesses, good practice examples, and concrete recommendations for improvements.

III. Preparing the SmartAid Submission

Participants in SmartAid are asked to provide documents that show their performance on each of the nine SmartAid indicators.

Because funders are organized and operated differently, it is impossible to list specific documents that should be submitted by all funders. Rather, it is important for funders to reflect on what each indicator is trying to measure based on the description provided in this guide and to provide the most appropriate documentation as evidence.

Funders submit their documents through a secure online platform that is accessible to CGAP and the Review Board. Once the initial submission is finalized, CGAP checks whether the submission is complete; additional documents may be requested. A phone interview is conducted to address remaining questions. In the interview, funders also have the opportunity to explain standard practice within their organizations and share information that is not captured in the submitted documents. After the submission is considered complete by both the funder and CGAP, it is submitted to the Review Board and can no longer be modified.

Funders' submissions to SmartAid include two key components: (1) documents that show their institutions' performance on each of the nine SmartAid indicators, and (2) a Submission Roadmap.

The Submission Roadmap includes three parts:

1. **At a Glance:** Funders are asked to complete a short questionnaire of general questions about their institution. The responses provide the Review Board with the context needed to better understand documentation submitted.

[4]Funders receive a score from 1 to 5 on each indicator, which is then multiplied by the weight of the indicator. This results in a maximum of 15 points on indicators one and three and a maximum of 10 points on the remaining indicators.

2. **Map of Project/Investment Cycle, Key Steps, and Responsibilities:** Funders are asked to describe their typical project/investment cycle, specifying responsibilities for key steps within the process and the involvement of microfinance specialists. The standard format given in the Submission Roadmap can be complemented with visuals or explanations.
3. **Questionnaire on SmartAid Indicators:** Funders are asked to respond to a set of key questions related to the SmartAid indicators. This gives the Review Board an indication of how funders estimate the state of practice within their institutions. All statements must be supported with evidence in the form of documents submitted.

The Review Board bases its analysis and scores on a thorough study of the Submission Roadmap and all submitted documents. The Submission Roadmap also allows funders to provide additional comments on the state of practice within an institution, in case there is no documentation available for an indicator.

The following are tips for preparing the SmartAid submission:

- ✓ **More documentation is not necessarily better**. If a document does not provide concrete "evidence" of the current policy or practice, it should not be included. The CGAP SmartAid team is available throughout the process to support funders with the preparation of their submission.
- ✓ **Documents can be relevant for more than one indicator**. For example, the financial inclusion strategy is most relevant for indicator 1, but can also include information on funding instruments (indicator 9). The online platform allows funders to upload a document for the most relevant indicator and to add references to all other indicators for which it might be useful.
- ✓ **Documents that show a policy or standard practice are preferred over sample project documents.** A template for monitoring reports, for example, is preferred over a sample monitoring report of a specific project. Sampling presents some challenges because (*i*) it is difficult to know the extent to which the sample is representative of the whole, and (*ii*) it takes a longer time to collect and review samples.
- ✓ However, **for some indicators, a sampling of project documents can be helpful**. In such cases, the Review Board will randomly select a small sample of projects from the portfolio information provided as part of the initial submission and will ask the agency to submit specific project documents for that sample. In that case, CGAP will also ask the funder to indicate how consistently the illustrated practice is applied.
- ✓ For some indicators, **access to a funder's Web-based systems might be more relevant than documents**. Whenever possible, funders are asked to provide Review Board members access to their systems (e.g., intranet, project database, knowledge management

platform, etc.). CGAP can organize an online demonstration of Web-based platforms if access cannot be provided to the Review Board directly.

- ✓ The **SmartAid Team is available** to advise funders on what documents to submit. Funders should use the full duration of the submission period to prepare their submission; this incorporates time for exchange and discussion.

IV. SmartAid Indicators

This section provides a brief explanation of the rationale and relevance of the nine indicators. For each indicator, the explanation is followed by a detailed listing of what SmartAid looks for in funders' policies and practices, as well as specific examples of documents a funder might submit to demonstrate the state of practice within its agency.

One objective of SmartAid is to show how funders progress over time, which requires keeping a constant set of indicators. For funders that have already participated in SmartAid, it is important to note that the indicators have not changed since the last round of SmartAid in 2011. Some changes have been made from 2009 to 2011 to further clarify the indicators and avoid overlap. Scores from the 2009, 2011 and 2013 rounds of SmartAid are comparable.

1. Funder has a policy and strategy that addresses microfinance, is in line with good practice, and is based on its capabilities and constraints.

A coherent vision improves quality at every level of an institution. A policy document articulates principles, guidelines, or standards that set a definite and binding common approach for reaching a funder's vision. In addition to laying out funders' visions and goals for financial inclusion, policy documents can also make the link between financial inclusion and the institution's overall development mission.

Strong policies and a clear vision are mutually reinforcing. Funders with strong policies that adhere to international standards embrace a financial systems development approach rather than emphasizing credit as an input or resource transfer. A policy does not dictate one way to support financial inclusion; rather it supports diverse approaches and priorities within a framework of basic good practice principles.

A funder's strategy for financial inclusion brings its policy into focus. Strategies for financial inclusion may be agency-wide or at the regional or country level. They might be integrated in a financial sector strategy or they may stand alone. Reflecting on internal capabilities and constraints can help funders formulate their strategies for supporting microfinance. A consideration of the broader funding landscape and where a funder can add value in relation to other donors and investors is also needed given the growing numbers of funders and the increasing pace of change in the financial inclusion space. Not every funder needs to—or can—tackle all gaps and challenges to building inclusive financial systems.

Also, funders need to make sure their interventions are in line with local needs and the stage of maturity of any given market. Rather than proposing a one-size-fits-all approach, a funder's strategy or operational guidelines should ensure interventions are based on a thorough market assessment and an analysis of other funders' activities in the same market.

Strategies that aim to develop inclusive financial systems that are sustainable in the long run require that a funder's activities respect additionality—a key principle in private sector development. Additionality is about whether a funder is producing or catalyzing a positive change that otherwise would not happen or would take much longer to happen. For example, is the funder filling a gap that would otherwise not be covered by local or other commercial funding sources? Strategies that prevent funders from distorting local markets and encourage them to leverage socially responsible investments or commercial capital are likely to have a stronger development impact.

Finally, strong support from senior management for policies and strategies and a clear signal that they are meant to be followed increase the likelihood that these policies and strategies will be internalized by staff, applied in their everyday work, and thus translated into results on the ground.

SmartAid looks for the following:

- Policies that are in line with **good practices**. The major tenets of good practices in microfinance are codified in *Good Practice Guidelines for Funders of Microfinance* (CGAP 2006).
- Policies that are **endorsed by management.** Official endorsement by the relevant management level sends a strong signal to staff that a policy is to be followed.
- Policies that are **binding**. SmartAid considers that only binding policies have a substantial influence on the quality of microfinance projects and investments. Whether a policy is binding not only depends on whether it is officially endorsed, but also on whether it provides mandatory guidelines for its implementation beyond theoretical suggestions, and whether there are mechanisms to check and enforce compliance.
- Policies that **take into account current issues and evolutions in financial inclusion.** Given how quickly the landscape is evolving, policies have to be reviewed and adapted periodically to remain relevant. Policies that take current issues into account and reflect the impact of new actors (i.e., entry of socially responsible investors or mobile network operators) and developments (i.e., technological advances, new industry standards such as client protection principles) serve as a relevant guide to staff and management.
- Policies that are **broadly disseminated and accessible** to staff. Policies are more effective if they are communicated broadly to staff and are easily accessible on the funder's Web site or intranet. Internal trainings or orientation sessions for new staff are good opportunities to communicate policies.

- Policies that are **user friendly**. Policies that are centered on the needs of operational staff and include clear operational guidance that can be used throughout the project/investment cycle (e.g., what to do, what not to do; templates; checklists; etc.) are more likely to be consulted by staff during project/investment design and implementation.
- Strategies that are based on realistic analyses of **internal strengths and weaknesses**, as well as **external opportunities and threats** (**SWOT**).
- Strategies that demonstrate an awareness of the broader funding landscape and emphasize the importance of **additionality and being responsive to market conditions.** Strategies that drive funders to leverage commercial funding and prevent crowding out of domestic funding sources are more effective in building inclusive financial systems.

Suggested documentation for submission:

- ☐ Policy for financial inclusion—can be part of a broader financial sector development or private sector development policy.
- ☐ Strategy for financial inclusion—can be part of overall strategy or country/regional strategies.
- ☐ Endorsement of the policy/strategy—letter from management, intranet printout, minutes of board meeting, etc.
- ☐ Evidence of accessibility—intranet printout, dissemination plan, agenda of training events, orientation for new staff, etc.
- ☐ Operational guidelines for staff providing guidance to implement the strategy.
- ☐ Evidence of SWOT and funding landscape analysis—can be part of evaluation reports, presentations, and other internal documents.
- ☐ Guidelines on additionality—can be part of strategy or stand alone, due diligence procedures/forms, and operational guidelines with additionality checks.

2. Funder has quality assurance systems in place to support microfinance projects and investments.

Experiences from the Microfinance Donor Peer Reviews, portfolio reviews, and country-level reviews strongly suggest that funders perform best when project/investment teams include microfinance specialists or when microfinance projects are at least reviewed by microfinance specialists.

Key decision points for quality assurance in the project/investment cycle include project design (prior to approval), approval, and monitoring and evaluation. Quality reviews that come early enough so that they can influence the design of the project/investment are the most effective, and, ideally, a specialist is included in the design team from the earliest

phases. Review prior to approval is especially important for microfinance components of nonfinancial projects as they are often designed by staff without microfinance expertise. Ensuring strong technical inputs throughout the project/investment cycle is one way to counteract approval and disbursement pressure that is prevalent in many funding agencies.

The way quality assurance is implemented may differ depending on the organizational type, structure, and size of the funding agency. Ideally, projects are designed by staff with extensive microfinance expertise and, in addition, reviewed by a different person (or committee) that is not involved in the actual project management and brings both microfinance expertise and an independent view on the quality of the project design.

In organizations that are highly decentralized and at the same time do not have a centralized quality assurance department, quality assurance typically relies on the capacity of specialist staff who are involved at all key steps of the project/investment cycle, regardless of where they are based (e.g., at headquarters or in country offices). In this case, quality assurance involves making sure those specialists have the skills and tools they need to design and manage high-quality projects. However, even in decentralized organizations it is recommended to have projects reviewed by someone other than the project manager.

In agencies where generalists design projects, quality can be enhanced if microfinance specialists are mandated to provide inputs and technical review throughout the project/investment cycle. In such cases, there should be strong incentives for project managers to follow the specialists' recommendations, e.g., through involvement of management in the review process or through a requirement to justify deviations from technical recommendations.

Quality assurance processes should involve the review of

- coherence of project with funder's financial inclusion strategy and national/regional priorities;
- adherence to international best practices;
- whether project design is based on a thorough assessment of local market needs;
- the value addition of the funder, and how it has been assessed (e.g., review of local funding landscape and funder's comparative advantage); and
- whether proposed funding instruments are in line with project objectives and structured and priced according to market conditions.

SmartAid looks for the following:

- Quality assurance processes that require the **participation of staff with sufficient microfinance skills in the project design and/or review, as well as the monitoring** of microfinance projects and investments.

- Quality assurance provided by staff who are **formally designated** to do so. Designations for the function of providing early technical inputs into project design or technical review—rather than portfolio management—can be formalized in terms of reference (TOR) of staff and/or in the description of a specific unit or group.
- Mechanisms for quality assurance that **match a funder's organizational structure** and are commensurate with the microfinance portfolio and the extent of expertise throughout the institution.
- Strong incentives to follow technical advice. Mandating that technical advice is taken into account is likely to result in the application of good practices at the project/investment level. The funder's processes should ensure that project managers have to justify cases where technical advice is not followed.

Suggested documentation for submission:

- ☐ Project/investment cycle policies and procedures (visual and explanations, if possible), highlighting key steps and decision makers, levels of approval, and whether a process for monitoring compliance is in place. Evidence should indicate at which stages technical expertise in project design or technical review is included, whether that review is optional or mandatory, and where projects/investments originate (i.e., what departments).
- ☐ Organizational chart that shows all different units working on microfinance and explains their role.
- ☐ Operational manual or policy describing responsibilities, quality assurance process, and the role of microfinance specialists.
- ☐ Job descriptions, TOR, and/or selection criteria of staff formally designated as responsible for quality assurance.
- ☐ Evidence that specialists' comments are taken into account (e.g., policy that makes specialists' comments binding, note to investment committee with specialists' comments, etc.).
- ☐ Quality assurance checklist used by technical reviewers or quality assurance committees.

3. Funder has the staff capacity required to deliver on its microfinance strategy.

Staff capacity is undoubtedly a critical success factor in the design, implementation, and monitoring of any project or investment. To successfully implement its strategy a funder needs a sufficient number of staff with the right skill mix to design, manage, and monitor projects and investments.

The number of qualified staff members needed to manage microfinance projects or investments depends on the institutional structure of the funder, the nature of its quality assurance mechanisms (indicator 2), and the size, composition, and dispersion of its portfolio. For example, a decentralized agency that counts on its field staff for ensuring the quality of its projects will need many more field-level staff with the right skills and training than another agency might.

Just as important as the number of qualified staff is whether their experience and skills match the funder's strategy and portfolio. Staff responsible for funding retail microfinance institutions need different skills than staff advising central banks on regulation and supervision of the financial sector. In the best scenario, the number and mix of staff working on financial inclusion and the skills and experience they offer are consistent with the type of interventions supported, the size of the overall portfolio, and the extent of financial inclusion expertise throughout the agency.

Building and maintaining staff capacity is an ongoing process and can be approached in many ways. Some funders have recruitment policies that prioritize hiring specialists with significant microfinance expertise. Others hire staff with less specific experience but have mandatory training for all new staff working on microfinance. Even experienced specialists need regular training to keep up with the latest evolutions in financial inclusion (e.g., mobile banking, microinsurance, savings services, etc.).

Beyond qualified project or investment staff, some level of microfinance knowledge or "basic literacy" is required within other functional units in an institution—this is often the case for risk management or evaluation departments, for example. Staff in these departments also have a say during the life cycle of projects or investments, and their opinions and decisions can influence current or future projects.

Funders that do not have sufficient capacity in-house can use external consultants to fulfill the role of microfinance specialists. Using a regular set of consultants or a database of preselected consultants can help compensate for insufficient in-house capacity. Nevertheless, having in-house specialist staff has certain advantages in terms of continuity and knowledge management over time. Even for funders that rely heavily on consultants, a minimal level of microfinance knowledge is required in-house. Basic microfinance knowledge is needed to select qualified consultants, ask the right questions, and interpret performance reports.

SmartAid looks for the following:

- Funders with a **sufficient number of qualified staff.** The number of specialists required depends on the institutional structure of the funder, the nature of its quality assurance mechanisms (indicator 2), and the size, composition, and dispersion of its microfinance portfolio.

- Strong match between the **skill sets of staff** and a funders' portfolio and strategic directions in financial inclusion.
- Funders that maintain staff with **microfinance expertise in-house,** whether at headquarters or in regional offices, to facilitate access to technical support.
- Funders that do not have sufficient capacity in-house require the procurement flexibility, budget, and network to **contract external consultants** as microfinance specialists.
- The availability of **ongoing training and skills-building** opportunities to staff. The appropriate frequency and subjects of such opportunities depend on the funder's microfinance skills base and the type of projects it supports. Increasingly, more specific specializations within financial inclusion are called for (e.g., savings, rural finance, policy work, etc.). Prioritizing training topics that match the funder's strategy and the content of its portfolio is most effective. Opportunities can be provided internally or externally (e.g., through staff exchanges).
- Funders that build and maintain **basic financial inclusion knowledge throughout** relevant departments (legal, procurement, evaluation, risk management, etc.) either through recruitment policies or by training staff.

Suggested documentation for submission:

- ☐ List and CVs of microfinance specialists indicating the share of their time spent on microfinance.
- ☐ CVs/bios or key qualifications of consultants or firms that are used extensively or on retainer for numerous assignments or who are prequalified/short-listed under framework contracts.
- ☐ List of staff managing microfinance projects/investments.
- ☐ Training/professional development plan, policy, or training requirement for staff responsible for microfinance.
- ☐ List of internal trainings or learning events offered, including participant lists.
- ☐ Evidence of participation in external training opportunities and exchange programs/secondments.
- ☐ Contracting/procurement rules (including selection criteria) with regard to selecting individuals and firms, including those with specialized financial inclusion/financial sector expertise. This includes evidence of unrestricted ability to hire the most suitable consultants, whatever their nationality.
- ☐ Budgets for hiring external consultants (firms and/or individuals).

4. Funder has a system in place that identifies all microfinance projects and components. An important first step in ensuring accountability for results is for funders to know about all their microfinance projects or investments, whether standalone or components. Simply identifying the full extent of the microfinance portfolio can be a challenge. For example, in many institutions, projects originate in more than one department or sector, and different units are involved over the course of the project cycle. A standardized project/investment identification system is needed to ensure the funder has a good overview of the entire portfolio and can thus provide technical support when needed.

While most funders can identify standalone microfinance projects or investments, many do not capture microfinance components within larger projects. As a result, these components often do not receive sufficient technical input and oversight. Project identification systems or databases that allow staff to assign multiple codes or markers to a project make it easier to capture such components.

Automated project identification systems that can generate updated lists of all microfinance projects and components on demand and cover the entire agency's portfolio are most useful for effective portfolio management. Clear coding guidelines and compliance checks can be used to make sure the information in the system is accurate and project codes are assigned correctly.

SmartAid looks for the following:

- Systems that can **easily produce updated lists** of the microfinance portfolio. The highest standard is for institutions to have lists that can be automatically generated at any point in time to provide timely information. Manual lists can also work, however, especially within smaller agencies with concentrated portfolios.
- Participation in CGAP Funder Survey and comprehensiveness of reporting (e.g., reporting of disbursed amounts, allocation by levels, etc.).
- Systems that provide lists that are **complete, covering the whole institution**, not just microfinance or financial sector departments. Both standalone projects and components of financial and nonfinancial sector projects should be included.
- Funders that **periodically check** that all relevant projects and components are being coded correctly so as to ensure that the list of projects or investments is accurate.
- Funders that have **clear guidelines for how to code** microfinance projects.

Suggested documentation for submission:

- ☐ Read-only access to database listing microfinance projects and investments, full printouts, or manually prepared list of microfinance portfolio.
- ☐ Completed CGAP Funder Survey Template.
- ☐ List of codes (and subcodes) that are used to identify microfinance projects and components.
- ☐ Coding guidelines or instructions.
- ☐ Evidence that regular checks are done to verify whether codes are applied correctly.
- ☐ Evidence of dissemination/training on use of codes beyond microfinance/financial sector departments. This is especially important for agencies that have components that originate from numerous departments.

5. Funder monitors and analyzes performance indicators for microfinance projects and investments.

Another important step in accountability for results is monitoring, analyzing, and reporting on performance. Beyond simply knowing what they are funding, funders gain by knowing the performance of their portfolio.

Projects that are required to report regularly on their performance are more likely to perform better. The more transparent the results, the more likely funders are to learn from successes and failures and to take corrective actions when needed. Funders can use performance information, measured against objectives, to decide whether to continue, replicate, or terminate a project.

Funders should not only track the performance of retail microfinance institutions they are funding directly, but also monitor the portfolio of intermediaries, such as microfinance investment vehicles (MIVs) or apexes. For interventions at the retail level, funders should use internationally agreed-upon indicators for tracking the performance of retail microfinance institutions (Rosenberg 2009). For interventions at the market infrastructure and policy level, standards are only emerging. The SEEP Network has developed financial performance indicators for microfinance associations, "Measuring Financial Performance: Practitioners Guide for Microfinance Associations," and IFC for measuring the effectiveness of credit bureaus, "Credit Bureau Knowledge Guide." Where no standards exist, funders should develop their own indicators to measure performance.

Aggregating portfolio information at the regional level or for the entire microfinance portfolio allows a funder to analyze performance patterns or identify problems. Reporting to a managerial level also strengthens accountability for the results of projects or investments.

SmartAid looks for the following:

- Requirement of **mandatory performance monitoring.**
- Requirement of **reporting,** with reports provided to staff responsible for monitoring the project and to a managerial level.
- Funders that collect information such as the **minimum indicators that donors and investors should track** (Rosenberg 2009). Industry standard definitions and calculations allow performance to be compared within the agency as well as with industry benchmarks.
- Reporting at **regular intervals,** at minimum annually, with semi-annually or quarterly considered a more appropriate frequency.
- Monitoring and reporting systems that include both funding provided directly to **retail financial service providers** and funding channeled through **intermediaries or wholesale facilities,** such as apexes or MIVs.
- Monitoring and reporting systems that include both **standalone projects and components.**
- Performance monitoring systems that take into account **social performance/responsible finance indicators** or qualitative proxies to get beyond the financial bottom line.
- Funders that use existing standards and monitor performance of all types of projects/investments. Such monitoring can include qualitative and quantitative information.

Suggested documentation for submission:

- ☐ List of standard performance indicators that are tracked for microfinance projects and investments.
- ☐ Policy requiring tracking and reporting of performance information at regular intervals.
- ☐ Read-only access to database with performance information on microfinance projects and investments or printouts of reports.
- ☐ Template for reporting performance information for retail microfinance providers or wholesale institutions.
- ☐ List of performance indicators for projects at the market infrastructure and policy levels.
- ☐ Evidence that performance information is consolidated and analyzed at least annually.
- ☐ Policy or standard practice that social performance is tracked in addition to financial performance.

6. Funder incorporates performance-based elements in standard agreements with partners. Loan and grant agreements formalize the relationship between a funder and its partner and state the obligations of both parties. Typical loan and grant agreements with retail microfinance institutions define the amount and modalities of funding, the permitted use of funds, the type and frequency of reporting required, as well as standard covenants about suspension or termination of funding.

In addition, standard loan and grant agreements can be used to define the expected results from an engagement and to create positive or negative incentives to achieve those results. Agreements that incorporate such performance-based elements are more likely to lead to the results the funder and the partner institution want to achieve.

An agreement is considered performance-based when (*i*) it is as clear and specific as possible about the expected results and how they will be measured, and (*ii*) it strengthens incentives for good performance by defining benefits or sanctions that are tied to the achievement of the expected results (El-Zoghbi, Glisovic-Mezieres, and Latortue 2010). Performance-based elements in a funding agreement include the following:

1. Clear set of indicators and targets for performance on these indicators
2. Minimum performance or "threshold" performance that is allowable on some of the indicators
3. Funding in tranches to allow for an ongoing incentive mechanism
4. Clear sanctions for noncompliance once performance falls short of minimum levels
5. Bonuses or other rewards for maintaining and exceeding targets set

Funders that use performance-based agreements need the mechanisms to monitor and track performance as set forth in the agreements. Regular reporting is required against the targets set in an agreement so that problems can be identified and actions taken, if necessary. Of course, the effectiveness of performance-based agreements depends on a funder's political will and ability to take action, including withholding payments or even terminating the agreement with nonperforming projects or partners. In cases of noncompliance for loan agreements, funders need to consider carefully that calling a loan may have broader consequences on the market and should use this option with care.

Agreements with all kinds of partners (apexes, microfinance institutions, technical implementers, and even governments) can include performance-based elements. The nature of the agreement, the performance targets, indicators, monitoring plan, and sanctions for noncompliance will differ based on the partner, the funding instrument and the type of project or investment.

SmartAid looks for the following:

- **Systematic use** of performance-based elements in agreements with microfinance institutions or wholesale finance institutions as a **matter of policy or standard practice**, for both standalone projects and microfinance components within larger projects.
- Agreements that incorporate key performance-based elements, such as minimum **performance targets, thresholds, and clear sanctions for noncompliance**. Mechanisms that incentivize performance, such as payment in tranches and bonuses for meeting or exceeding performance targets, are also important features of performance-based agreements.
- Clear **designation of staff** responsible for monitoring performance-based agreements.
- **Reporting** that compares actual performance to the targets set in agreements.
- The use of performance-based elements in agreements with all **partners, such as technical service providers or government agencies**.
- Evidence of **actions taken** when partners do not meet minimum thresholds defined in the performance-based agreement. Actions taken are responsible and take into account their impact on the broader market.

Suggested documentation for submission:

- ☐ Policy or procedure requiring loan and grant agreements with retail microfinance institutions and wholesale institutions to be based on performance.
- ☐ Standard template of performance-based loan and grant agreements.
- ☐ Evidence that compliance is tracked regularly (e.g., monitoring report, tracking sheet, etc.).
- ☐ Evidence of action taken in case of noncompliance (e.g., letter to the partner institution, minutes of meeting with partner, etc.).
- ☐ Agreements with nonretail partners, such as government agencies or technical service providers, that include performance-based elements.

7. Funder regularly reviews the performance of its microfinance portfolio.

Evaluations of individual microfinance projects are key to accountability, generate lessons learned, and influence project implementation when they are done mid-term. Such evaluations, however, have limited influence on future operations or strategic decisions.

Reviews that go beyond disconnected evaluations of individual projects and cover a funder's full microfinance portfolio, or an important cross-section thereof, can yield

more meaningful learning. Understanding what worked well, what did not, and why can inform future project designs and strategic reorientations and thus improve performance.

Characteristics of portfolio reviews

Objectives	✓ Learning
	✓ Accountability
Scope	✓ Review of a funder's microfinance portfolio or a significant cross-section
Focus	✓ Portfolio composition
	✓ Project performance across portfolio
Analytical Tools	✓ Systematic approach (scoring) to compare performance across the portfolio
	✓ Desk review complemented with input from staff and project stakeholders

Portfolio reviews have emerged as a methodology to analyze a funder's performance throughout its entire microfinance portfolio. A portfolio review analyses the composition of the microfinance portfolio and the performance of individual projects across the portfolio to assess whether a funder delivers on its microfinance strategy.

Portfolio reviews can cover the full portfolio or examine a specific subset of projects (e.g., projects in a specific region, projects with a similar thematic approach, or projects funded through the same instrument—e.g., greenfields).

Several methodologies can be used to review the performance of a funder's microfinance portfolio; the key is to carefully analyze actual performance information on individual projects with a standardized method of measuring the performance (e.g., scoring of individual project performance). Depending on the quality of a funder's internal monitoring systems, portfolio reviews can rely to a certain extent on secondary data, such as monitoring reports or consolidated standard performance indicators (Rosenberg 2009). Most commonly, portfolio reviews include a comprehensive review of project documents combined with field visits.

Reviews can cover various time spans; those that take a long-term perspective can also cover learning from terminated projects. These assessments can be carried out as internal or external evaluations.

SmartAid looks for the following:

- Assessments/reviews that cover a significant section of a funder's portfolio and, at minimum, check **performance**, **achievement of targets**, and **compliance with strategy and good practice principles**. This includes both financial and social performance as benchmarked against the institution's objectives.
- Comprehensive reviews that are done **regularly,** somewhere between every three to five years as appropriate.

- Reviews that **assess the funder's additionality** when supporting microfinance projects and investments.
- Reviews that touch on the **quality of the funder's work**. While many factors influence results, funders should reflect on whether their own inputs (advice, design, etc.) made an effective and appropriate contribution.
- Reviews that are conducted by **microfinance specialists**, whether internal or external.
- Reviews that, once completed, are shared within the agency and trigger **discussions** and a **management response** around the results.

Suggested documentation for submission:

- ☐ Policy or standard practice that requires regular, systematic reviews of the microfinance portfolio.
- ☐ List of all portfolio reviews of microfinance/financial access work over the past 15 years.
- ☐ Full reports of portfolio reviews conducted in the past five years.
- ☐ TOR of upcoming portfolio reviews.
- ☐ Evidence of dissemination of portfolio reviews and discussions held (e.g., staff meetings, management committee meetings, etc.).
- ☐ Evidence of how portfolio review results are used, including actions taken and plans for changes resulting from reviews.

8. Funder has systems and resources for active knowledge management for microfinance. Knowledge management includes identifying, creating, disseminating, and using knowledge. It entails practices used to capture and learn from one's own—and others'—experiences. Actively managing knowledge is above all an organizational value and requires strong support from senior management to become ingrained in the culture of a funding agency. Ensuring a strong exchange between staff based in headquarters and staff in country/regional offices facilitates the exchange of institutional knowledge and diverse experiences. Effective knowledge management requires appropriate tools, mechanisms, and incentives.

Knowledge management systems have to be adapted to the organizational structure, communication culture, and size of an institution. Tools and mechanisms typically used for active knowledge management include vehicles to share information (Web-based platforms, regular meetings), incentives for staff to act as knowledge managers (include knowledge management in job descriptions, budget for knowledge management activities), policy of systematically capturing and sharing knowledge (policy to make project

documents available to all staff), and the distilling of knowledge into products that are shared with staff (case studies, learning events).

SmartAid looks for the following:

- **Job descriptions** that include knowledge management.
- Policy or institutional culture that makes key project documents **available on shared platforms** for easy internal access (e.g., consultant reports, appraisal reports, evaluation reports, back to office memos, etc.).
- Opportunities for **face-to-face interactions** among staff of different levels, locations (headquarters and field), etc.
- **Budgets** to support knowledge management. Budgets can be used both for participating in internal events and taking advantage of others' learning events and conferences, and supporting Web sites, newsletters, resource centers, communities of practice, collaboration platforms, etc.

Suggested documentation for submission:

- ☐ Agency-wide policy on knowledge management (e.g., position paper on knowledge management, notes from management, etc.).
- ☐ Templates of job descriptions including core knowledge management tasks to be performed by different categories of staff (e.g., microfinance specialists, project managers, investment officers, etc.).
- ☐ Access to intranet pages showing types of documents available on shared platforms. If not possible, printouts of key pages.
- ☐ List of regular internal meetings that provide opportunities for knowledge exchange (e.g., weekly meetings among specialists, regional meetings, meetings between specialists and generalists that cover microfinance, microfinance network meetings, etc.).
- ☐ List of learning events and sample of agendas and participants lists.
- ☐ Budget line item for maintaining knowledge management systems.

9. Funder has appropriate instrument(s) to support the development of local financial markets.

Funders have an important role to play in developing pro-poor financial market systems. They can act as market facilitators and help crowd-in mainstream investors and local capital.

As development agencies, funders play a temporary role in a market and have to make sure they provide development additionality (i.e., they contribute to the development of a functioning market system where their interventions are not needed in the long term). When intervening in a market, funders have to reflect on whether their support contributes to market development, beyond benefitting the institution receiving funding. Conversely, they need to avoid crowding-out commercial and local funding sources (including client deposits).

Additionality is a principle that needs attention at all stages of the project/investment cycle. The strategy and operational guidelines set the stage by defining the rationale for a funder's interventions and by describing how the different instruments should be used to add value. Funders can include additionality checks in their due diligence or in project/investment approval processes. Guidelines on how to structure and price instruments can help staff adapting interventions to market conditions. For example, cost-sharing guidelines and market-based pricing methods can limit the risks of crowding out. Ultimately, an intervention is additional if it contributes to market development. Funders should therefore have a clear vision of when and how to responsibly exit from a funding relationship with an institution or from a given market to avoid dependence on development assistance. At any time in the project/investment cycle, a funder should be able to articulate how its interventions lead to sustainable change and ideally, measure progress against this vision.

While a range of instruments is needed to build inclusive financial markets, not every funder needs to have a broad palette. The suitability of the instrument(s) for the activities supported by a funder and the way they are used in a given market is what matters, not the number of instruments.

Governments are natural partners when funders work on the policy environment and the regulatory and supervisory framework. However, for work on other levels and especially the retail level, it is harder to build the capacity of retail financial service providers if funders must channel all or almost all support through government bodies. Funders whose primary instrument is large loans to governments often have a comparative disadvantage with regard to supporting retail financial service providers. Experience has shown that governments are usually not suited to directly manage wholesale lending projects. However, exceptions do exist where governments select intermediary bodies that have the systems and technical skills to appraise retail institutions, provide implementation support, and track performance.

Funders that are able to work with a range of private actors are well-suited to support the retail (micro) and market infrastructure (meso) levels. Working effectively with private actors requires internal processes that are sufficiently flexible and efficient.

Channeling funding through components of multisector projects can undermine performance. If the microfinance component represents only a small part of a multisector project, it is unlikely to receive the technical attention needed. A perceived trade-off between

supporting sustainable financial services and meeting specific objectives for a target group may lead funders to neglect sustainability. As a result, components often decapitalize quickly due to high costs, subsidized interest rates that do not cover costs, and poor collection rates. Without sustainability, services may cease when a project is completed.

SmartAid looks for the following:

- Funders that have instruments that **fit their strategy** for microfinance and give them the means to appropriately fulfill their strategy.
- Funders that consider and analyze the **additionality** of their projects and investments at project design and when reviewing their portfolio.
- Funders that define responsible **exit strategies** when designing projects and investments.
- For debt: Funders that offer loans in **local currency** and price loans responsibly and **in line with local market conditions**.
- For grants: Funders that use grants for **time-bound** interventions with longer term benefits for the institution and the market. The use of grants should be **transparent** (e.g., not hidden in concessional loan terms) and **performance-based**. Funders should give grants only after assessing the grantee's capacity to sustain project benefits beyond the duration of the grant and use cost-sharing mechanisms to enhance ownership.
- For loans to governments: **Limited use of loans to governments to fund retail financial services.** Little microfinance programming through credit components of larger, non-financial sector projects, or systems to ensure technical oversight if used regularly.

Suggested documentation for submission:

- ☐ Detailed description of the use, terms, and conditions for each instrument (e.g., grant, debt, equity, guarantee).
- ☐ Policy or operational guidance on credit components, and an indication of the percentage (volumes) of the microfinance portfolio that is done through credit components.
- ☐ Guidelines and mechanisms to check additionality of projects and investments focused on financial inclusion (e.g., due diligence guidelines or pricing guidelines that include additionality checks).
- ☐ List of investments exited and evidence of exit strategies for active projects/investments.
- ☐ Pricing policy for loans (understanding that pricing is market specific, general policy, or approach to pricing would be useful).

Resources

CGAP. 2006. *Good Practice Guidelines for Funders of Microfinance*. Washington, D.C.: CGAP.

El-Zoghbi, Mayada, Jasmina Glisovic-Mezieres, and Alexia Latortue. 2010. *Performance-Based Agreements: Incorporating Performance-Based Elements into Standard Loan and Grant Agreements*. Technical Guide. Washington, D.C.: CGAP.

Rosenberg, Richard. 2009. *Measuring Results of Microfinance Institutions—Minimum Indicators That Donors and Investors Should Track*. Technical Guide. Washington, D.C.: CGAP.