Background

The SmartAid Index measures and rates the way funders with an interest in financial inclusion work. Heads of 29 major development institutions endorsed CGAP’s development of the Index.¹

The premise of SmartAid is simple: funders with strong management systems are better equipped to support financial inclusion effectively. Its indicators assess five areas agreed by all funders as critical for effective financial inclusion: 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 financial inclusion projects. 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 financial inclusion 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.

Five funders— AFD Group (AFD/PROPARCO), EIF, IFAD, MIF and UNCDF —participated in SmartAid 2013, increasing the total number of funders participating in the SmartAid Index to 19. Prior rounds have included the participation of AECID, AFD, AfDB, AsDB, CIDA, EC, EIB, FMO, GIZ, IFC, ILO, KfW, SDC, and Sida. Three agencies from the 2013 round participated in prior SmartAid rounds (IFAD, MIF and UNCDF). AFD (AFD/PROCPARCO) and EIF are both considered new participants given that different units in the agencies participated in prior rounds.² 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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¹See the Better Aid for Access to Finance meeting, 2006: www.cgap.org/betteraid_meeting/compact.
²In the case of AFD/PROPARCO, AFD participated in the 2009 round and the submission did not include Proparco. For EIF, two departments of the EIB Group’s Directorate of Operations – Africa, Caribbean and Pacific region, and the Mediterranean region—participated in the 2011 round and did not include EIF.
Key Findings

Agence Française de Développement’s (AFD) and the Société de Promotion et de Participation pour la Coopération Économique (PROPARCO) together representing the AFD Group received 70 out of 100 points, meaning that overall it has “good” systems in place to support microfinance. As the graph below shows, AFD/PROPARCO received a high score of 4.1 (on a scale from 0 to 5) on indicator 9 (instruments). Scores were only slightly lower on quality assurance and project identification system (indicators 2 and 4), and still 3 or above on staff capacity, performance indicators, performance-based agreements, portfolio reviews and knowledge management (indicators 3, 5, 6, 7 and 8 respectively). AFD/PROPARCO’s lowest score is on strategic clarity (indicator 1).

AFD Group is composed of AFD and PROPARCO. AFD itself is composed of several divisions intervening in microfinance: Financial and Private Sector Development division (IFP), Ariz and the Division of Partnership with NGOs (DPO). This SmartAid report includes both AFD and PROPARCO, which together increasingly present a united and complementary approach of doing business in microfinance for the Group.

<table>
<thead>
<tr>
<th>At a Glance</th>
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<tbody>
<tr>
<td>Type of funder:</td>
</tr>
<tr>
<td>Microfinance portfolio (committed as of 12/12):</td>
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<tr>
<td>Microfinance as % of total portfolio:</td>
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<tr>
<td>Number of projects:</td>
</tr>
<tr>
<td>Primary level(s) of intervention:</td>
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<tr>
<td>Primary instrument(s):</td>
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<td>Primary source of funding:</td>
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At a Glance (continued):

- Strategic clarity
- Quality assurance
- Staff capacity
- Project identification system
- Performance indicators
- Performance-based agreements
- Portfolio reviews
- Knowledge management
- Appropriate instruments

Median scores and Minimum/Maximum scores are marked on the graph for SmartAid 2009/13 and AFD/PROPARCO 2013.
The AFD Group’s focus and support to microfinance has advanced considerably since 2000. Once considered a failing activity within its rural and agriculture operations, microfinance at AFD has become an integral focus area within the financial sector development program, supported by a strong team of technical experts. PROPARCO, which was created in 1977 and started working in microfinance in 2007, is 59% owned by AFD. It maintains a strong team of microfinance specialists and increasingly invests in microfinance institutions. While there are small pockets of microfinance programming via its support to French NGOs (DPO) and its guarantee facility (Ariz), for the most part, the AFD Group’s support to microfinance emanates from IFP and PROPARCO. This 2013 submission reflects an initiative by the AFD Group designed to gain a consolidated view of its microfinance operations across its two most important units supporting microfinance. This effort is noteworthy and should be recognized as leading ahead of peers, which for the most part remain siloed as separate operating entities. This movement in harmonizing operations across the entire AFD Group should continue and should be reflected formally in AFD’s operational systems.

Key Strengths and Weaknesses

- **Strategic Clarity (2.9/5.0).** AFD Group’s strategy, outlined in the *Cadre d’intervention du groupe AFD dans le secteur de la microfinance* covering 2008-2010, is the current working document outlining the group strategy for microfinance. AFD Group’s portfolio review completed in 2011 was intended to feed into the development of a revised strategy document. At the operational level, the microfinance teams at AFD and PROPARCO share a common understanding as to their complementary roles and do actively coordinate activities. To date, this is a reflection of the individuals involved and their relationships, as opposed to a corporate strategy that extends to all staff operating in these two entities. AFD/PROPARCO’s operations reflect the orientation of a sound and up to date vision for financial inclusion including support for innovation, commitment to rural finance, a focus on responsible finance comprising social performance measurement and application of client protection principles. In all but name, AFD/PROPARCO has the pieces to develop a formal and management approved updated financial inclusion strategy for the AFD Group as a whole. This opportunity to seek clarity and support at the highest management levels should not be missed, particularly as the existing strategy is from 2007. AFD/PROPARCO’s current operations have certainly advanced well beyond the vision articulated in that document, and the latest portfolio review provides an excellent basis on which to build.

- **Quality Assurance (4.0/5.0).** Nearly all AFD/PROPARCO projects are designed or reviewed by microfinance specialists. Specialists are also involved in partner assessments and lead negotiations of terms and conditions with partners. The project approval processes differ somewhat between AFD and PROPARCO. All AFD/PROPARCO projects undergo a rating exercise, the “notation qualité”, based on DAC criteria; in addition, all counterparts with loans and/or equity are scored based on risks (“Fiche d’évaluation des risques” – FER). Both local AFD offices and microfinance specialists from the head office are involved in project monitoring. Reports are submitted by partners on either a quarterly or semi-annual basis. Other tools, such as the “grille d’analyse des projets” and the “grille d’analyse des risques” also serve as important monitoring instruments. While microfinance specialists are central to the design and monitoring process, there may be some projects that do not benefit sufficiently from such expertise, such as guarantees and projects initiated by DPO, which get reviewed but input is non-binding. However, the opinions of microfinance specialists are rarely, if ever, ignored.
Staff Capacity (3.5/5.0). AFD/PROPARCO’s core team of microfinance specialists represents a strong, albeit small, team of professionals with experience and educational backgrounds to support microfinance. The team offers annual training in microfinance to onboard new staff and to reach field staff involved in managing microfinance operations. All of the team has also participated in industry training events such as the Boulder Institute, CERISE methodology training or GIRAFE methodology training. Despite this solid capacity, AFD/PROPARCO could benefit from additional training on topics of interest for AFD/PROPARCO’s future direction such as rural and agriculture finance, branchless banking, and Islamic microfinance, among other topics. To complement the team’s work, AFD/PROPARCO could expand the use of consultants to conduct market feasibilities and other support functions given its relatively small team and the increasingly specialized nature of emerging issues in financial inclusion. Due to certain confidentiality requirements, AFD/PROPARCO staff must retain the central role on project design and appraisal.

Project Identification System (3.9/5.0). AFD/PROPARCO’s existing project identification system allows the organization to produce a list of all microfinance projects. Microfinance components, while prevalent many years ago, have for the most part been phased out. Areas where AFD/PROPARCO may continue to improve include a periodic check on the coding system in order to ensure that all projects are indeed captured.

Performance Indicators (3.3/5.0). AFD/PROPARCO tracks a standard set of performance indicators, both financial and social, on either a quarterly or bi-annual basis. There is a qualitative and financial evaluation of projects every six months (FER), which is used to adjust provisioning. Additionally, the Environment and Social Scorecard, developed with the support of CERISE, covers a wide range of social indicators, including responsible growth and responsible profits. When funding MIVs, AFD/PROPARCO requires quarterly information on the investees of the MIV. While there is much to be admired on performance indicators, AFD/PROPARCO is still missing a centralized database that captures key performance indicators for monitoring and learning purposes. On the investment side, PROPARCO conducts semi-annual reviews of investments which help to analyze project performance. Nonetheless, AFD/PROPARCO would benefit from a systematic review of the entire performance of its microfinance portfolio on a regular basis to extract lessons and to make corrective actions along the way.

Good Practice Highlight
Learning from the Portfolio

In 2011, AFD completed an ambitious portfolio review of all of its microfinance operations across AFD and PROPARCO. The review followed best practices incorporating both a quantitative review of performance of all AFD Group’s microfinance projects alongside qualitative analysis of AFD Group’s overall strategic direction and impact. The review highlighted several key findings including stronger performance of newer projects in the portfolio and demonstrated improvements in project design and supervision over time. Also, projects funded directly by the Group, rather than through an intermediary, showed higher performance. The review noted a need for stronger supervision and the importance of partner selection. The Portfolio Review has provided meaningful guidance for immediate operational changes and given food for thought for AFD’s future direction including its role in supporting rural finance, innovation, and responsible finance. It reinforced the need for a unified vision between AFD and PROPARCO.
- **Performance-based Agreements (3.4/5.0).** Since the 2009 SmartAid round, AFD has introduced the use of performance-based agreements. However, these are limited to the use of grants and of equity in investment funds, and have not been extended to other instruments such as guarantees or projects funded through DPO. Loan contracts do include some performance elements, but generally focus on reducing risk of non-payment rather than rewarding performance. Most relationships with microfinance institutions at IFP involve both a loan and a grant, but AFD/PROPARCO links the performance elements only to the grant segment of this relationship. Incentives to partners would be significantly strengthened if both grants and loan agreements were aligned with similar performance expectations and rewards. Funders are experimenting with various incentives including interest rate discounts, cash prizes, and eligibility for new products. Penalties have included acceleration of the loan or delay in disbursement of funding tranches. Extending performance agreements to all instruments at the AFD Group would also further harmonize operations and improve the organization’s effectiveness throughout.

- **Portfolio Reviews (3.5/5.0).** The 2011 portfolio review (see Good Practice Highlight) is comparatively among the best. The process, the depth of analysis, the strong team of evaluators used, and the synopsis report with key findings were all of excellent quality and provided a solid set of recommendations for AFD to consider. In addition to the review of projects, the portfolio review also looked closely at AFD’s strengths, weaknesses, opportunities and threats (SWOT), providing meaningful analysis on the potential for AFD moving forward. In addition to this notable review, AFD also invested in a review of its microfinance operations in fragile states, which helped to draw lessons for future operations in these environments. Both of these reviews were collaborative efforts between the evaluation department and the operational units within the AFD Group, allowing for strong technical oversight of the evaluation process while maintaining relevance from an operational stand point. These efforts bode well for AFD’s ability to be a learning organization. However, AFD/PROPARCO has not fully leveraged the review toward the development of a new strategy for financial inclusion across the AFD Group.

- **Knowledge Management (3.0/5.0).** AFD/PROPARCO has continued to share knowledge and learning across the AFD Group through a microfinance network mailing list, periodic meetings, and other knowledge management events on microfinance. Project documents are readily available through the SIOP internal tracking system and knowledge management is explicitly included in job descriptions, giving it internal importance. While notable, the knowledge management system remains somewhat ad hoc and heavily reliant on the time availability of key staff driving the agenda while being responsible for project design and supervision. In addition, AFD/PROPARCO could benefit from a more formal policy on knowledge management and a structured method for hosting events on microfinance. As earlier noted, AFD’s evaluation department produces excellent evaluations and research which could also be further leveraged by dissemination through knowledge management platforms.

- **Appropriate Instruments (4.1/5.0).** Combined, AFD and PROPARCO have a broad suite of instruments (grants, debt – both concessional and market-based, equity, guarantees) to serve the needs of various markets at different stages of development. The two entities collaborate and provide complementary funding to their partners. There is also a strong focus on lending in local currency. AFD/PROPARCO conducts thoughtful economic analysis of market conditions before making a decision on the instrument to be used. This market-based approach bodes well for allowing AFD/PROPARCO to meet
the different developmental stages of market actors in which they invest. Clearly, AFD/PROPARCO is among the leading funders using instruments to support market building; however it is always important to continue to improve and explore additional ways to stay ahead of the curve. AFD/PROPARCO should continue to articulate and develop tools to help measure how it adds value with investments and grants. A continued focus on understanding when and how exits from investments are responsible for the market as a whole, in addition to the investee, would help the broader investor community advance practices on this issue.

**Recommendations**

The advances made by the AFD Group since 2000 are extremely positive and show a commitment to strong execution at the operational level. While a relatively young institution in microfinance, PROPARCO has clearly benefited from AFD’s trajectory. The ongoing efforts to harmonize and show a complementary front for the AFD Group are quite exceptional. This SmartAid Review supports this trajectory and encourages the AFD Group to maintain momentum towards continual institutional learning by signaling the need at this time for a “rejuvenation” of AFD’s strategy and vision for support to financial inclusion.

The following suggestions emerge from the SmartAid review:

- **Build on momentum; articulate a new strategy and seek management approval.** There is no doubt that the AFD Group has advanced its vision and continues to evolve to meet the needs of the markets in which it works. This progress could easily be undermined if it is not made explicit, particularly in light of upcoming management and staff changes. While development of strategies are formally triggered by board requests, this does not preclude an articulation of a vision for financial inclusion and how AFD and PROPARCO can complement one another operationally moving forward. Once a vision is articulated, seeking internal buy-in and formalization becomes a second order of concern. The current strategy vacuum reflects a lack of institutional recognition of AFD Group’s microfinance activities and might limit the Group’s ability to evolve and innovate to respond to emerging market needs.

- **Reinvigorate knowledge management to support excellence throughout the agency.** In the past several years, AFD/PROPARCO has continued to manage knowledge sharing platforms such as the microfinance discussion listserv. While this tool is still used regularly, knowledge sharing is not as vibrant as it could be at the AFD Group. For example, research papers and evaluations that are produced by AFD’s evaluation unit could be further leveraged. These documents can be made more accessible and “usable” by operational staff by repacking them in more succinct formats and delivering them through relevant channels accessed by operational staff (e.g. brown bags, short lesson notes). Incorporating knowledge management in job descriptions, investing in knowledge management platforms, or hiring dedicated individuals with communications backgrounds are some measures funders have taken to strength the institution’s ability to share technical knowledge across busy staff in the head office and the field.

- **Consolidate and analyze performance indicators on a regular basis.** While AFD/PROPARCO has good systems in place with regard to performance indicators, several improvements can be made to leverage what has already been developed. First, establishing more consistency across contracts would enable the AFD Group to extract broad lessons from different projects. Second, analyzing this data through consolidated reports also helps to extract operational learning along the way, rather than only at the
evaluation phase. Third, the social scorecard currently used jointly is very strong and can be further
exploited by analyzing different data points such as the highest and lowest scores or looking for trends.

- **Continue to build and invest in microfinance expertise in light of evolving industry.** AFD/PROPARCO
  has benefitted from a dedicated team of microfinance specialists who have continued to advance the
  institution’s work in microfinance well above and beyond expectations. Yet the institution may be at
  risk of losing the many years of investment made if the next generation of specialists is not nurtured to
  build on this strong legacy. With many of AFD/PROPARCO’s microfinance specialists having recently
  rotated or are about to transition to new positions, it is important that the institution formalizes its
  support to building internal staff capacity. Additionally, AFD/PROPARCO should further invest in the
  ongoing skill-building and updating of knowledge of existing microfinance specialists so that they
  remain at the vanguard of the industry. AFD/PROPARCO’s interests and the needs of the evolving
  industry require ongoing learning and skill development in topics such as responsible finance, rural and
  agricultural finance, Islamic microfinance or branchless banking.

- **Establish a system for regular portfolio reviews.** AFD/PROPARCO can use the positive and relevant
  outcomes of the 2011 portfolio review to continue this best practice to remain at the forefront of being
  a learning organization. Building on this exercise, AFD/PROPARCO could develop an internal
  methodology to regularly review the consolidated performance of its portfolio, while also committing
  to regular external reviews.

- **Extend performance based agreements to loans.** AFD uses performance-based agreements for
  incentivizing performance of its grant partners. Following this successful track record, these types of
  agreements should be reviewed for their applicability to AFD loans. In addition to standard covenants
  which serve to reduce the risk of non-payment, some funders make explicit performance benchmarks
  pertaining to certain social and financial indicators such as rural or gender outreach, efficiency or
  profitability in loan agreements. Compliance is then linked with specific rewards, such as reduced
  interest rates, eligibility for a larger loan, or penalties including acceleration of the loan or fines.
  Integrating clear performance targets into loan agreements ensures that partners maintain a shared
  vision toward specific market outcomes with the AFD Group.
Methodology

SmartAid distills learning from over eleven 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 2009-2013 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 2009-2013 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.
SmartAid Index Indicators

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

**MAXIMUM SCORE** 100 points

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), AFD/PROPARCO, African Development Bank (AfDB), Asian Development Bank (AsDB), Australian Agency for International Development (AusAID), Canadian International Development Agency (CIDA), European Commission (EC), European Investment Fund (EIF), 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)

Authors

Mayada El-Zoghbi with important contributions from Review Board Members Heather Clark, Kathryn Imboden, Klaus Maurer and Alice Nègre.