

SMARTAID FOR MICROFINANCE INDEX 2009

DEUTSCHE GESELLSCHAFT FÜR TECHNISCHE ZUSAMMENARBEIT (GTZ)



Background

The SmartAid for Microfinance Index measures and rates the way microfinance funders work. Heads of 29 major development institutions endorsed CGAP’s development of the Index.¹

The premise of SmartAid is simple: funders with strong management systems are better equipped to support microfinance effectively. Its indicators assess five areas agreed by all funders as critical for effective microfinance: strategic clarity, staff capacity, accountability for results, knowledge management, and appropriate instruments.

SmartAid enables funders to understand how their systems, policies, procedures, and incentives affect their work in microfinance. An independent, external assessment, the Index highlights strengths and areas for improvement. It can also provide an impetus for funders to take action, prioritize changes, and hold themselves to account for their own performance.

Funders support microfinance with the goal of reducing poor people’s vulnerabilities and increasing their incomes. Having the right systems is a necessary, not sufficient, condition for achieving this goal. SmartAid does not, however, evaluate the quality of programs on-the-ground.

SmartAid Indicators

1	Funder has a policy and strategy that addresses microfinance, is in line with good practice, and is based on its capabilities and constraints
2	Funder has designated microfinance specialist(s) who are responsible for technical quality assurance throughout the project/investment cycle
3	Funder invests in microfinance/access to finance human resources
4	Funder has a system in place that flags all microfinance programs and components
5	Funder tracks and reports on performance indicators for microfinance programs and components
6	Funder uses performance-based contracts in its microfinance programs and components
7	Funder regularly conducts portfolio reviews
8	Funder has systems and resources for active knowledge management for microfinance
9	Funder has appropriate instrument(s) to support the development of local financial markets

Ten funders—AECID, AFD, AfDB, EC, GTZ, IFAD, ILO, MIF, SDC, and UNCDF—participated in SmartAid 2009. This diverse group 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.

¹ See the Better Aid for Access to Finance meeting, 2006: www.cgap.org/betteraid_meeting/compact.

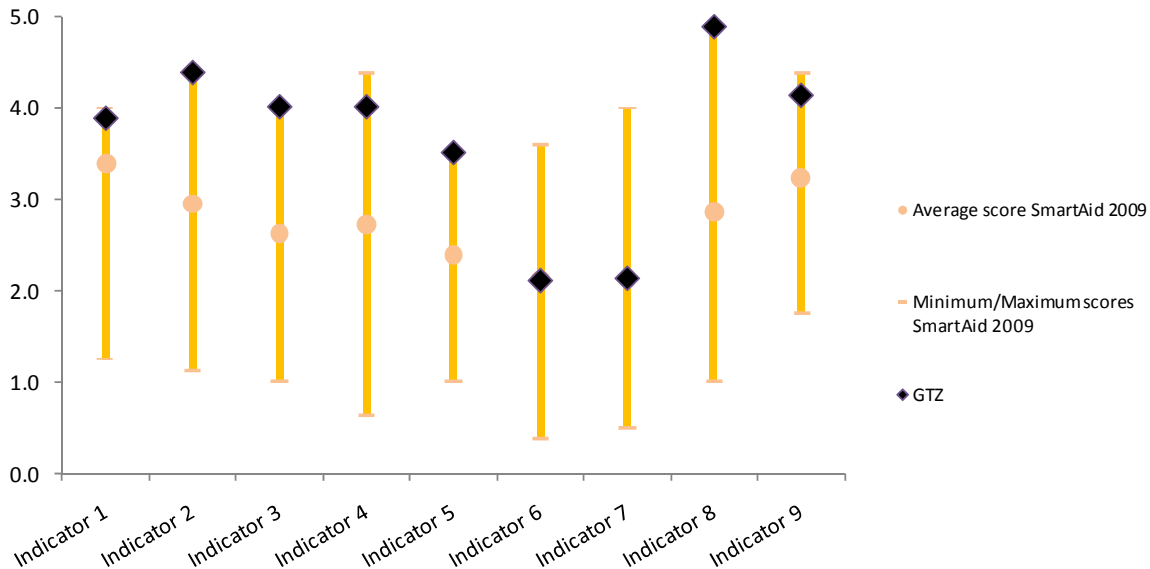
Key Findings

GTZ received 74 out of 100 points, meaning that overall the agency has “good” systems in place to support microfinance. As the graph below shows, GTZ received scores of 4 or higher, on a scale from 0 to 5, on five of the indicators, including a near perfect score on knowledge management (indicator 8) and a very strong score as well on specialists with responsibility for quality assurance (indicator 2). The agency also performed very well on strategic clarity, investments in human resources, flagging systems, and appropriate instruments (indicators 1, 3, 4 and 9). Performance was significantly weaker on two indicators focused on accountability for results, including performance-based contracts and portfolio reviews (indicators 6 and 7).

GTZ has a unique status in the development cooperation community. A government-owned international cooperation enterprise for sustainable development with the German Federal Ministry for Economic Cooperation and Development (BMZ) as its main client, GTZ’s core competence is capacity development. GTZ’s institutional model of providing technical cooperation (TC) offers substantial advantages for supporting financial sector development, a sector that requires high technical inputs. The driving force of GTZ is its staff and consultants. In microfinance, it invests in hiring technical specialists, coaching younger staff on-the-job, and placing experts both in Eschborn and in country offices. Recognizing that human capacity requires ongoing nurturing and development, GTZ also has extensive systems for knowledge management. All the above, combined with flexible grants as its main instrument, positions GTZ well to implement BMZ’s comprehensive Sector Policy Paper on Financial Systems Development. However, GTZ would benefit from building in more mechanisms for accountability both for its own results, and with regard to how it structures its relationships with partners.

At a Glance	
Type of funder:	Bilateral Agency
Microfinance portfolio (committed as of 12/2007):	\$228 million
Microfinance as % of total portfolio:	2.5%
Number of projects:	26
Primary level(s) of intervention:	<input checked="" type="checkbox"/> Retail <input checked="" type="checkbox"/> Infrastructure <input checked="" type="checkbox"/> Policy
Primary instrument(s):	Grant
Primary source of funding:	Public funds

GTZ Scores



Strengths

- **Good and binding Sectoral Policy Paper on Financial System Development (FSD).** All GTZ microfinance projects funded by BMZ are subject to the BMZ Policy Paper on Financial System Development. The Policy Paper is in line with good practices, accessible, endorsed, and includes unequivocal language about its binding nature: “Provided no exceptional agreement is made with BMZ for the individual case, these procedural guidelines are binding for the implementing agencies of German development cooperation.” Importantly, the Policy is implemented in thoughtful Focal Area Strategy Papers (Schwerpunktstrategiepapier) for FSD in partner countries. For example, several strategy papers include requirements for cooperation and topics of sector dialogue that underscore key principles in the Policy Paper such as sustainability, promoting savings, and avoiding interest rate controls. The Policy also seems to be consulted beyond project approval, and Project Progress Reports ask about compliance with the relevant BMZ policies.
- **Excellent FSD focal point.** GTZ has a strong seven-person FSD focal point whose primary role is to provide advice and backstopping to the regional departments and project managers in country offices. They are microfinance experts with strong curricula vitae, exceptional academic qualifications, and solid quantitative skills. Many are career GTZ staff, though a few have previous experience with different public and private organizations like Bankakademie, Deutsche Bank, FAO, and IPC.
- **High-caliber experts design or review all Financial Sector Development projects.** Several factors safeguard the technical quality assurance role provided by the FSD section of the Planning and Development Department, i.e., the focal point. First, based on a culture that prioritizes technical skills and inputs, the focal point de facto writes or reviews all new FSD projects. Second, the FSD focal point must sign off all relevant offers (AURA Angebote) that go to BMZ, thus ensuring a compulsory step for quality review. Third, review by the focal point is obligatory in the case of credit funds.
- **Specialist skills are valued, sought after, and cultivated.** GTZ has good recruiting, orientation, and training systems in place, reflecting a keen awareness that its main asset is human resources. All candidates go through an assessment center (OPAL), and the FSD focal point is automatically included for FSD job openings. A formal traineeship program, financed by BMZ, helps groom recent graduates through on-the-job training and exposure to both headquarters and country offices. A guide for supervisors of junior specialists is a creative way to help build the core competencies of junior staff. Staff going to FSD projects in the field spend at least one week with the FSD focal point for a thorough orientation. Additionally, staff can attend external training programs like the Boulder Microfinance Training Program and the CGAP funder course. As a result, GTZ has an impressive contingent of about 40 staff, including the focal point, that are mapped to the FSD profession, with over 85 percent working full-time on microfinance. Full-time GTZ staff are further complemented by a strong roster of consultants.
- **Coding and FSD project monitoring systems enable good support to microfinance projects.** The use of several OECD DAC and CRS codes easily allows for automatic tracking of all financial sector projects. The focal point makes extra efforts to add in microfinance components of larger non-financial sector programmes by searching for additional CRS codes. Given the deep involvement of specialists in the project cycle, including the AURA offers, and

the relatively small number and size of FSD projects at GTZ, there is little risk of projects being missed.

- **Knowledge management (KM) is ingrained in organizational culture and core systems.** A recipient of many awards by several external knowledge management experts, KM is of paramount importance at GTZ. All staff are considered knowledge managers, as attested by job descriptions, and are trained in an obligatory course on the subject. There is also a corporate Chief Knowledge Officer with staff, budget, and a newsletter. This corporate commitment translates to FSD work through the sector networks (global and regional), the bi-weekly FSD team meetings (“Jour Fixe”), quarterly retreats, and the explicit knowledge management objective of the Project Progress Reviews. A unique element of the GTZ KM approach is the multiple opportunities created for face-to-face exchange among staff, including the regular rotations from headquarters to the field. This approach is aligned with the agency’s main value-added—its staff.
- **Grant instrument matches strategy and technical cooperation mandate well.** Grants are the ideal instrument for capacity building, which addresses one of the key obstacles to financial systems development. GTZ can and does work through private actors, though much of its work is usually through governments.

Good Practice Highlight

It Will Not Just Happen: A Manual to Systematically Promote the “Art” of Knowledge Management

GTZ’s “Knowledge Management for Project Managers and Other Decision-Makers” manual provides an excellent guide to translate a lofty idea, knowledge management, into the daily operations of staff. The manual includes a sequence of steps, methodology, and tools relevant for staff to use when working with teams and with partner institutions. It covers theoretical aspects from “what is knowledge” to the practical considerations of how to file and store joint work. This companion piece to the mandatory course on knowledge management for all GTZ staff is a user-friendly, fun, and practical.

Weaknesses

- **Agreements with partners may not incentivize performance.** Several factors may make it difficult for GTZ to include clear performance elements in its agreements with partners. Half of the FSD portfolio consists of technical assistance (TA) projects to the policy level whereby GTZ staff implements technical assistance directly, rather than giving grants to an institution for TA purposes. There are thus few incentives for GTZ to put in place stringent performance targets and consequences for non-compliance on its own staff. Moreover, it is politically sensitive to specify—and enforce—performance indicators when the partner is the government. Although the AURA Angebote include good indicators and conditions for success, these are not included in the Implementation Agreement for Technical Cooperation Projects. GTZ does have a template performance-based contract for its work with non-government partners at the retail and market infrastructure levels. The template grant agreement does not include minimum performance thresholds and clear consequences for non-compliance, though it does incorporate reporting requirements.
- **No comprehensive review of FSD portfolio completed in last 10 years.** GTZ rarely commissions independent reviews of a significant cross-section of the microfinance portfolio, though it has a strong culture of individual project evaluations. Yet, experience suggests that broader portfolio reviews—as opposed to individual project evaluations—are more likely to lead to learning that feeds into the agency’s operations and new programming. The last such review that covered all projects with credit funds was done in 1996. The effectiveness of this kind of thematic portfolio review is demonstrated by the substantial changes GTZ made as a

result. The selection of microfinance as the theme for GTZ's annual evaluation in 2009 is a promising development.

- **Performance monitoring system has weak spots.** First, the evidence received indicates that key performance indicators for projects at the retail level include little information on collection (portfolio at risk) or sustainability. Second, the only required reporting is for BMZ through the annual Project Progress Reports and the Project Progress Review done at the end of each phase of a project. Projects each develop their own reporting systems, but it is uncertain whether the FSD focal point regularly analyzes the whole portfolio of projects to track overall performance. There appears to be no central place where performance information is collected, beyond the individual Project Progress Reports.
- **GTZ Microfinance Operations due for an update.** The 2004 GTZ Microfinance Operations which puts the BMZ Policy Paper into operational context for the agency does not take into account the evolution of microfinance in the past few years, the entrants of new microfinance funders, and the recent clarification of the relationship with KfW. Moreover, the 2004 document does not sufficiently address GTZ's strengths, weaknesses, opportunities, and threats to help define clear parameters of intervention. Finally, the link between this document and other papers on products like Islamic banking, microinsurance, rural finance, etc., is not clear.
- **Credit components in non-financial sector programs – is quality assurance as rigorous?** About 40 percent of the GTZ microfinance portfolio is in components in non-financial programs. While there is a strong culture of technical quality assurance at GTZ, it is uncertain whether these components receive the same level of FSD technical inputs as the rest of the portfolio. Experience with numerous development agencies has shown that it is often more difficult to select the right partner and to bring the appropriate technical inputs to bear in financial components of non-financial projects.

Recommendations

With elements of both a typical bilateral development agency and a consulting firm, GTZ is a unique institution. For the most part, these dual identities have served it well. As a consulting-like entity, technical expertise is highly valued, and there is a clear career path both in Eschborn and country offices for financial sector specialists. This strong penchant for specialist skills is uncommon in the majority of bilateral development agencies and is a core comparative advantage that GTZ should continue to nurture. Also, GTZ actively invests in ensuring staff are client-centric and responsive to the multitude of factors that help build the capacity of partners, well beyond the needed technical skills. This is reflected in the Capacity WORKS model. GTZ's identity as a bilateral donor comes from its close relationship with BMZ as one of the Ministry's key implementing partners. BMZ ensures GTZ's clear focus on the development mission, provides a mandate for active participation in donor coordination platforms, and drives many of the formal accountability mechanisms.

Overall, GTZ has strong core systems to continue working with BMZ and other clients in financial sector development. The only area that requires immediate attention is the agency's systems for accountability. GTZ essentially provides technical assistance through a network of staff and consultants. Staff may therefore find it difficult to assess the quality of their own advisory work. It is thus particularly important for GTZ to put in place more robust accountability systems. GTZ should rethink what management requires to monitor performance well and ensure that results are achieved.

The following suggestions emerge from the SmartAid review:

- **Incorporate performance elements in agreements with partners for meso and macro level work.** While difficult, creative efforts should be made to apply performance elements beyond the retail level, for example, with projects that support national microfinance associations as well as policy work. For example, GTZ should explore whether any of the “requirements for cooperation” or “topics for sector dialogue” and other indicators included in the AURA Angebote can be meaningfully integrated in Implementation Agreements when the partner is the government. Clear performance indicators provide powerful incentives, set clear expectations, and can strengthen partnerships. Decisions about continuing a relationship should be based on evidence that progress is being made on the joint objectives defined. To implement an approach that more explicitly defines common performance expectations, it is critical to understand whether BMZ will provide the necessary political support.
- **Identify the best methodology and team to conduct the thematic microfinance review.** Management has already selected microfinance as the theme for the 2009 annual evaluation. At the time of the SmartAid review, the terms of reference were not yet available. If not yet finalized, GTZ should ensure that the review focuses on obtaining performance information of projects on-the-ground. For support to the retail level, efforts should be made to collect performance information, including collection, profitability, etc. The review should also look at the quality of GTZ’s own inputs. GTZ could also benefit from looking at the approaches used successfully by other funders. Once finalized, the results should be shared broadly for discussion on lessons learned that can help improve future operations.
- **Expand technical quality assurance role to performance monitoring.** The FSD focal point actively engages in quality assurance at the project design stage. Yet even the best designed projects can yield poor quality results without careful attention during implementation. The FSD focal point should consider how it can best support performance monitoring of the overall FSD portfolio, including determining what information is needed beyond the project level. The solution could be as simple as having a specialist from the focal point check the Project Progress Reports in the Data Management System (DMS) periodically for an analysis of the overall portfolio and draft a short synopsis report. For support to the retail level, the focal point should ensure that all projects, at minimum, select the relevant indicators from the list of good practice core performance indicators.
- **Update GTZ Microfinance Operations.** GTZ should review and sharpen the strategic priorities in this document given how the funding landscape and market needs have evolved and specify where GTZ can best add value. GTZ’s offer in microfinance should be based on a thorough analysis of strengths, weaknesses, threats and opportunities (SWOT). Management should also consider the merits of having separate documents for all the product lines, such as rural finance and Islamic banking. If these documents are to remain separate, some thought needs to be given as to how they can be linked by common good practice principles. With this revision, the document could serve as a useful operational guide for staff, not only for marketing purposes.
- **Double-check the performance of financial components in non-financial projects.** GTZ should check to see if the components in non-financial projects are producing good results. This check could be included as a specific area of attention in the thematic review planned for this year (and mentioned above). Depending on the results, GTZ may need to design new procedures for quality assurance of financial components in non-financial projects.

Methodology

SmartAid distills learning from over seven 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.

Feedback from funders confirmed that the five core areas of effectiveness at the heart of SmartAid present a comprehensive picture of what funders need to support microfinance effectively. After a pilot round in 2007 and an external evaluation, the Index was refined and streamlined. SmartAid 2009 is thus the baseline year.

SmartAid 2009 uses nine indicators to assess funders’ internal management systems. 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. Averages as well as minimum and maximum scores shown in the graph in the Key Findings section change depending on the funders participating in each SmartAid round.

Dispersion among reviewers for the final scores was minimal. For all scores (per indicator and funder), the standard deviation was less than 0.5. Naturally, as a margin of error is unavoidable in this nature 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.

It may be difficult for funders to make improvements in all indicators simultaneously, but experience suggests that even the largest of institutions can make positive changes. Over time, CGAP will perform trend analysis on SmartAid results to track evolutions within and across microfinance funders.

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

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%
Staff Capacity	2	Funder has designated microfinance specialist(s) who are responsible for technical quality assurance throughout the project/investment cycle	15%
	3	Funder invests in microfinance/access to finance human resources	10%
Accountability for Results	4	Funder has a system in place that flags all microfinance programs and components	10%
	5	Funder tracks and reports on performance indicators for microfinance programs and components	10%
	6	Funder uses performance-based contracts in its microfinance programs and components	10%
	7	Funder regularly conducts portfolio reviews	10%
Knowledge Management	8	Funder has systems and resources for active knowledge management for microfinance	10%
Appropriate Instruments	9	Funder has appropriate instrument(s) to support the development of local financial markets	10%

Funders participating in SmartAid 2009

Agencia Española de Cooperación Internacional para el Desarrollo (AECID), Agence Française de Développement (AFD), African Development Bank (AfDB), European Commission (EC), Gesellschaft für technische Zusammenarbeit (GTZ), International Fund for Agricultural Development (IFAD), International Labour Organization (ILO), Multilateral Investment Fund (MIF), Swiss Agency for Development and Cooperation (SDC), United Nations Capital Development Fund (UNCDF)

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.

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