CGAP

SMARTAID FOR MICROFINANCE INDEX 2009

UNITED NATIONS CAPITAL DEVELOPMENT FUND (UNCDF)

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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.

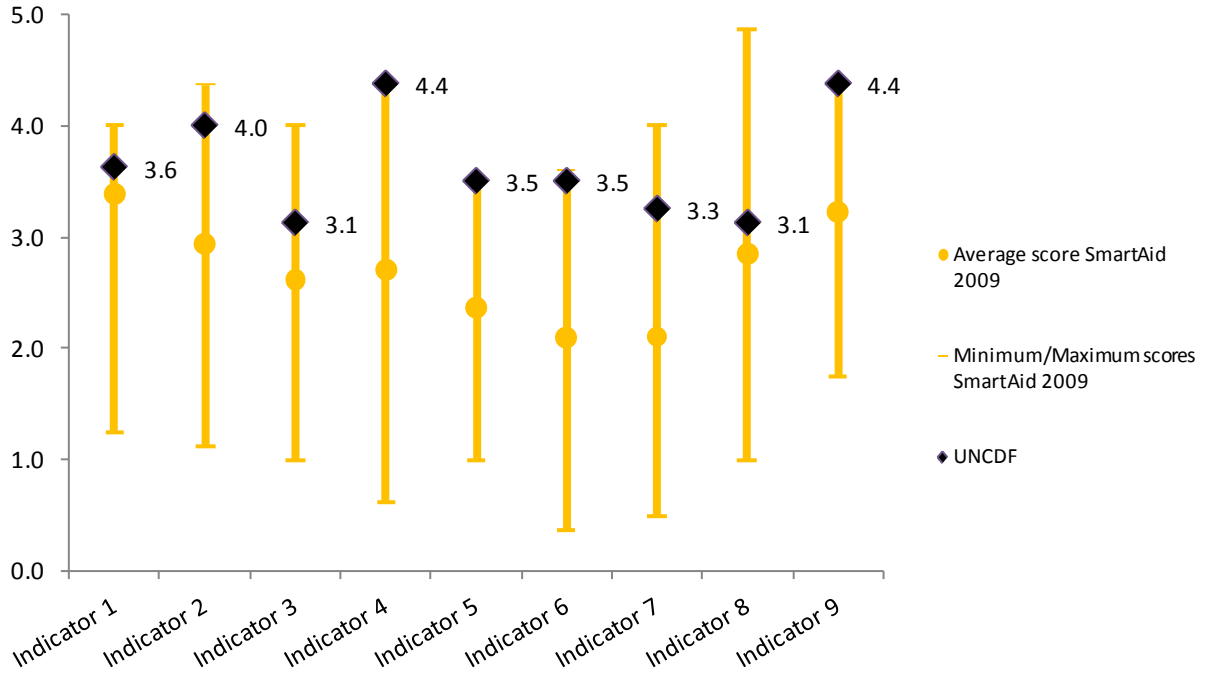
Key Findings

UNCDF received 73 out of 100 points, meaning that overall the agency has "good" systems in place to support microfinance. As the graph below shows, UNCDF received no scores below 3, on a scale from 0 to 5, on any indicator. Its strongest performance is on specialists with responsibility for quality assurance and systems to flag microfinance projects as well as appropriate instruments (indicators 2, 4 and 9). It was relatively weaker—though still on the right track—on investments in human resources beyond the focal point and knowledge management systems (indicators 3 and 8).

At a Glance	
Type of funder:	UN Agency
Microfinance portfolio (committed as of 12/2007):	$30 million
Microfinance as % of total portfolio:	20%
Number of projects:	17
Primary level(s) of intervention:	☑ Retail ☑ Infrastructure ☑ Policy
Primary instrument(s):	Grant
Primary source of funding:	Public funds

As a United Nations organization affiliated with UNDP, UNCDF works exclusively on two sectors—microfinance and local development. UNCDF has harnessed well this small scale and narrow focus that provides considerable advantages. In-house specialists identify all microfinance programs from inception and participate systematically in review and approval. With grants as the primary instrument and flexible procurement systems, UNCDF has ample margin to maneuver the implementation of its strategy for Building Inclusive Financial Sectors. However, matching staff experience and skills to the ambitious role the agency has set out for itself—facilitating market development at all three levels of the financial system in 25 countries—is a challenge. Mechanisms to ensure constant learning among regionally dispersed staff appear to need improvement. Increased opportunities for the agency to extract learning from the performance of its own portfolio as well as those of others would be helpful for implementing the strategy.

UNCDF Scores



Strengths

- **Strategy for Building Inclusive Financial Sectors consistent with good practices**. Developed with the participation of a broad range of staff, UNCDF's strategy is user-friendly and lays out the agency's approach to promote inclusive financial sectors. The strategy gives clear guidance for staff to follow international standards, promote scale combined with good practice, and engage with the private sector. Endorsed at the highest level, the strategy is binding and reflected in UNCDF's key operations guide, the Policies, Programmes and Operations Manual (PPOM). The emphasis on good practices and a binding policy are particularly useful given UNCDF's focus on difficult markets and fragile states.
- **Responsiveness to evaluations and reviews.** The refinement and evolution of UNCDF's strategy over the years demonstrates an exceptional willingness and proven ability to change based on feedback. A major turning point in 1999 was the abolition of credit components in the local development portfolio following an external review.
- **Strong technical staff with mandate to review and approve all microfinance programs.** The PPOM unequivocally states that the advice of financial specialists is binding for all UNCDF programming related to inclusive finance. These operational guidelines further state that "failure to follow this technical advice is the basis for UNCDF to suspend programming." These provisions send a strong message that technical quality cannot be shunted aside.
- **Size and experience of focal point matches portfolio.** UNCDF enjoys an enviable staff-to-portfolio ratio with its 10-person strong in-house focal point. Placing experienced focal point specialists in the field is consistent with UNCDF's strategy.
- **All microfinance programming captured by coding system.** Five codes for microfinance are provided in the PPOM, and the list of projects is periodically reviewed by management to ensure there is no leakage. UNCDF's other sector, local development, is attentive to ensure that no unflagged microfinance or credit components enter the project pipeline. The Fund can easily produce updated information on microfinance projects.
- **Policy and tools for mandatory performance monitoring and transparency in place.** The requirement for regular (mostly quarterly) reporting is highlighted in the strategy and PPOM. To operationalize this requirement, performance monitoring is included in the job descriptions of field staff, who receive easy-to-use worksheets to calculate indicators. UNCDF's results framework is aligned with good practice core performance indicators, and the Fund encourages its partners to report to the MIX (www.themix.org).
- **Flexible grant funding aligned with strategy**. UNCDF's primary instrument, grant funding, is well suited to its risk-taking approach and focus on retail institutions in LDCs. UNCDF works through direct implementation rather than national implementation through government, which is appropriate for the private sector focus

Good Practice Highlight

Excellent Policy and Tools for Performance –Based Agreements

Performance Based Agreements (PBAs) are the standard in practice within UNCDF. Deviation from the standard template requires review by UNCDF's legal department. To operationalize the use of PBAs, UNCDF developed a document that highlights the main components of a PBA such as setting core performance targets and benchmarks. It also provides guidelines on follow up actions required when benchmarks are missed. Finally, the document includes sample enforcement letters, making it a complete and easy-to-use tool for all staff. There is recent evidence that staff sent a series of letters to partners highlighting areas of missed performance and indicating that funding could be stopped. Management discussed the importance of PBAs at an annual staff retreat to ensure staff awareness and promote the tool's systematic use. Responsibility for enforcement lays not with the project officer, but with his/her manager, thus aligning incentives well.

the Fund seeks to foster. UNCDF can also lend in local currency. All microfinance programs are stand alone; there are no credit components in non-financial projects. The ability to reassign funds among programs in the inclusive finance practice area reduces potential disbursement pressure. The recent MicroLead Facility is an excellent use of UNCDF's core expertise and flexible instruments. The facility provides incentives for financial service providers from the South to expand to the poorest and post-conflict LDCs consistent with UNCDF's strategy.

- **First annual retreat is good model for technical exchange and learning.** Held just once to date, the annual retreat for inclusive finance staff working in Africa to discuss strategic and operational issues is an excellent way to promote learning and coherence among staff facing common challenges.

Weaknesses

- **Capacity and comparative advantage to implement broad strategy is lacking.** The case for UNCDF's role as an investor in retail finance institutions is strong, but far less robust with regard to work at the macro and meso levels. It is not clear how UNCDF will operationalize the facilitation role described in the strategy, or how the participation of other funders and stakeholders will be ensured for the implementation of these key strategic areas. Setting high expectations at the country level with government is risky, without plans to follow-through or capacity to make things happen.
- **Insufficient diversity among staff skills/experience.** Staff skills are strong for a funder with a retail finance focus, although not yet necessarily well suited for the facilitation role UNCDF has articulated in its strategy. The multiplicity of actors working in the financial sector and the fast pace of evolution in microfinance sets the bar high. To date, most staff have similar profiles with an impressive number of years working with retail financial institutions in LDCs. This profile limits UNCDF's ability to work on the infrastructure and policy issues that are part of its strategy. Moreover, training may not be the best way to acquire the missing skills since training courses are not readily available nor necessarily the best mechanism for knowledge transfer in these areas.
- **Performance monitoring is patchy.** Despite considerable efforts to standardize reporting and to provide tools for monitoring, UNCDF does not appear to have a clear and timely picture of overall portfolio performance. Some project data is missing, anomalous, or very late. The apparent tolerance for incomplete and late reporting suggests a laxity with respect to monitoring performance compliance.
- **Implementation of performance based agreements (PBAs) is incomplete.** Two main challenges exist. First, serious efforts to enforce PBAs are very recent. The December 2008 clean-up effort is good, but it is unclear whether a system is in place to trigger immediate follow-up when performance thresholds are missed. Also, the letters focused narrowly on portfolio at risk, and missed the opportunity to communicate broader performance issues with partners. Second, the standard usage of the 25 percent threshold for missing a target does not always seem meaningful.
- **Review of major strategic shift overdue.** UNCDF shifted to a sector-based approach in 2002.The results of this major shift have not yet been evaluated.
- **Insufficient knowledge management (KM).** UNCDF's own SWOT analysis recognizes several challenges presented by staff, including being insular from others and having trouble keeping up with the fast pace of change in microfinance. However, recent efforts to establish a new knowledge management staff position, the annual retreat, and a listserv are promising.

Recommendations

UNCDF's main comparative advantage is working with, and strengthening, retail institutions—still the most binding constraint in most LDCs. UNCDF has invested heavily in building up a decentralized network of staff and is often one of the first funders with good practice experience to enter frontier markets. The new facility, MicroLead, exemplifies the best of UNCDF, building on its core strengths while innovating through partnerships with strong Southern providers and an emphasis on savings. As a specialized and focused institution, UNCDF is in the privileged position to have inclusive finance specialists maintain control of the portfolio throughout the project cycle.

UNCDF's strategy includes work at all three levels of the financial system. While UNCDF has tried to operationalize this approach, it has not sufficiently equipped itself to do so, nor has it stepped back to assess if this strategy is effective. In areas where UNCDF clearly does maintain a comparative advantage, it has not focused its monitoring and evaluation efforts on obtaining quality data at consistent intervals that can help the agency influence performance of its partners.

The following suggestions emerge from the SmartAid review:

- **Clarify UNCDF's value added for all parts of the strategy.** UNCDF should review all components of the strategy, determine what resources it has to implement them, and what additional investments are needed. Specifically, UNCDF should get clearer about what "facilitation" means in practice, including the resources needed to do it, and how the agency will know whether its facilitation is successful. UNCDF should also clarify its role at the market infrastructure (meso) level. UNCDF cannot possibly work effectively on all fronts in this area. Current strengths appear to be more in supporting national associations and transparency initiatives rather than in the creation of credit bureaus, the development of payments systems, or financial sector policy initiatives.

  It appears that the agency faces a clear choice—either narrow UNCDF's strategic focus or hire solid, in-house expertise for effective work on policy and market infrastructure.

- **Set clear incentives for better performance by retail finance partners.** UNCDF's current comparative advantage is supporting young microfinance institutions. To build on that advantage, UNCDF will need to dedicate more energy to monitoring and improving the performance of its retail finance portfolio. The assignment of one staff member to monitor the performance of institutions in Africa is a good first step.

- **Re-think "triggers" for performance-based agreements**. Staff negotiating PBAs might re-examine how targets are set, and the allowable percentage that can be missed. The systematic use of a 25 percent threshold seems arbitrary; its standard use may present missed opportunities for UNCDF to define acceptable levels of performance for the agency's investments.

- **Commission an in-depth portfolio review.** In addition to looking at on-the-ground project performance, this review should evaluate the sector approach, including national strategies and facilitation, as well as results of infrastructure activities.

- **Identify opportunities to increase learning among staff.** Maintaining the all staff retreat as an annual event is positive. In addition, sub-regional meetings for staff in field offices where UNCDF is most active would be helpful. Outside experts could be invited to bring fresh views.

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.

	Points	Range
★★★★★	90–100	Very Good
★★★★½	80–89	
★★★★☆	70–79	Good
★★★½☆	60–69	
★★★☆☆	50–59	Partially Adequate
★★½☆☆	40–49	
★★☆☆☆	30–39	Weak
★½☆☆☆	20–29	
★☆☆☆☆	10–19	Inadequate
½☆☆☆☆	0–9	

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.

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 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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