CGAP

SMARTAID FOR MICROFINANCE INDEX 2009

MULTILATERAL INVESTMENT FUND (MIF)

★★★★☆

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.

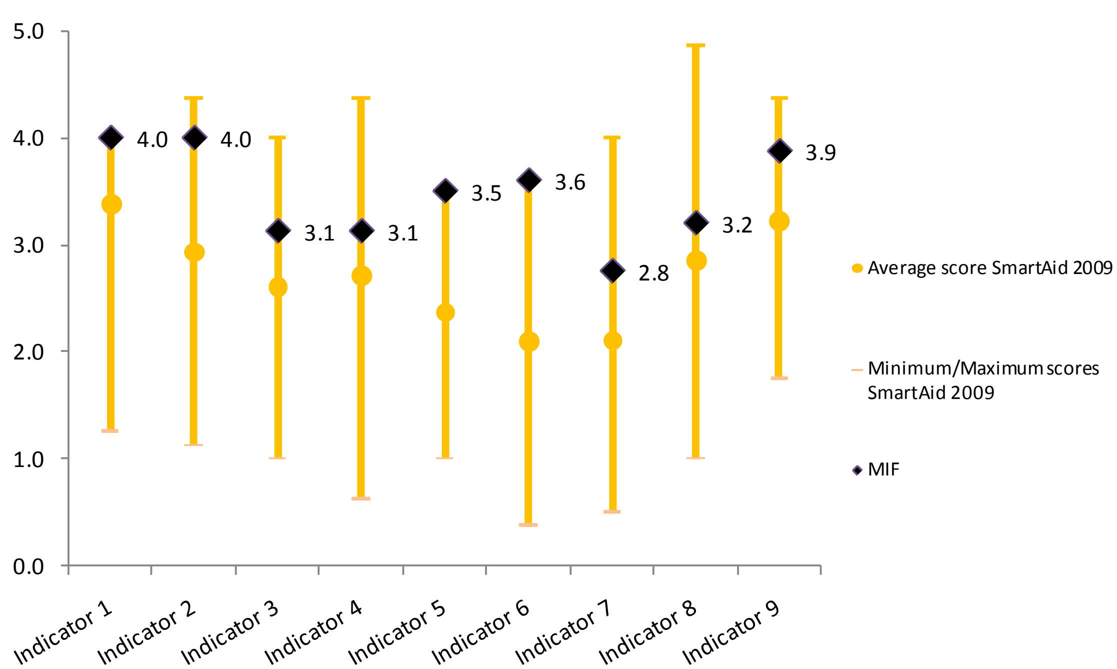
Key Findings

At a Glance	
Type of funder:	Development finance institution
Microfinance portfolio (outstanding as of 12/2007):	$52 million
Microfinance as % of total portfolio:	12.8%
Number of projects:	37
Primary instrument(s):	Commercially-priced debt
Primary source of funding:	Public funds

MIF received 70 out of 100 points, meaning that overall the Fund has "good" systems in place to support microfinance. MIF did well with scores of 3.9 or 4, on a scale from 0 to 5, on strategic clarity, specialists with responsibility for quality assurance, and appropriate instruments (indicators 1, 2, and 9). The Fund's lowest scores are concentrated in accountability, including flagging systems, performance-based contracts, and portfolio reviews (indicators 4, 6, and 7).

MIF, a specialized fund focused on private sector development, has a long history of support to microfinance in Latin America. To guide its next steps, the Fund has a clear and ambitious microfinance strategy with a full suite of instruments to implement it. It is able to recruit and retain a core team of qualified professionals that primarily support advanced retail providers—the backbone of the financial sector. While MIF's in-house specialists review all microfinance projects at the design phase, primary responsibility for monitoring grants rests with country office staff that may not have microfinance expertise. There are also concerns about the robustness of quality assurance and systems for accountability. The flagging system apparently misses microfinance components (estimated at less than 15 percent of the portfolio). Also, performance monitoring systems show several gaps and there has not been a thorough review of the portfolio performance.

MIF Scores



Strengths

- **Tripling Microfinance by 2012 articulates a clear, well-reasoned, and ambitious positioning for MIF.** The strategy is endorsed by the Donors' Committee, integrates good practices, and is written in an unequivocal style that provides staff with clear dos and don'ts. Specifically, MIF's strategy addresses head-on issues that are particularly critical to development finance institutions (DFIs), including additionality. It calls for MIF to avoid straightforward lending to top tier institutions, to price at market rates to prevent crowding out other players, and to innovate in the areas of new niches and new products with higher initial risks. The strategy also provides explicit direction about the available instruments, their use to help MFIs access local market deposits and debt, and the importance of technical assistance to speed up institutional capacity, build human capital, and test new models.
- **Strong team of specialists involved in all project designs and review.** The 12 Access to Finance staff who spend at least 50 percent of their time on microfinance have the appropriate banking, restructuring, NGO, microfinance and Latin American experience to implement MIF's strategy. The microfinance specialists are directly involved—often as team leaders—from the beginning of the project designs ensuring that projects moving forward in the pipeline comply with good practices.
- **Easy access to good consultants.** MIF has a flexible procurement system to access appropriate technical expertise when needed and has a solid database of consultants.
- **Flagging system in place.** MIF has a coding system that includes one code, "MIC" with seven sub-codes, several of which may be appropriate for microfinance. The coding table and internal project list is accessible to staff on the intranet and can be used to generate updated lists of stand-alone microfinance projects.
- **Detailed templates and tools available to collect portfolio information regularly.** MIF has good templates for monitoring loan and equity investments monthly, and technical assistance grants semi-annually. Through these templates, the tracking system can generate consolidated data on number of clients, amounts committed, disbursed, and outstanding, and internal rate of return achieved. The annual development effectiveness report consolidates much of this data with the addition of some high-level arrears information. The most extensive template, the Expanded Supervision Report, goes one step further and tracks detailed financial and social performance indicators.
- **MIF's knowledge capital is a well-established public good for the industry, and internal knowledge management is improving.** MIF's leading role in organizing the annual Inter-American Forum for Microenterprise exemplifies the Fund's well-respected technical competence and deep networks in Latin American microfinance. Importantly, MIF has recently stepped up efforts to improve opportunities for learning and exchange internally. The Innovation and Knowledge Management Unit (IKM), with a dedicated budget, can support the Access to Finance team in developing a community of practice and capturing lessons. The project reporting template includes a lessons learned

Good Practice Highlight

A Partner in Times of Crisis: MIF's Emergency Liquidity Facility

MIF has consistently been at the forefront of the microfinance industry, seeking responsive funding mechanisms for current local issues. Most recently, MIF has launched the Emergency Liquidity Facility (ELF).

ELF was created to support MFIs experiencing disruptions resulting from natural or financial crises. The ELF also aims to strengthen the ability of MFIs to deal with crises and emergencies, by providing technical assistance for preparedness by MFIs. It is a lender of last resort and focuses on building the institutions' overall ability to respond to crises.

section which helps to create a conscious effort to learn from past programs. The Access to Finance team holds weekly meetings. These nascent initiatives are important to help MIF staff achieve the ambitious strategy.

- **Responsive and innovative instruments.** One of the MIF's greatest strengths is its range of instruments (debt, equity, guarantees, grants) that are well-adapted to pursue the Fund's strategy. MIF can, and does, work with all types of partners, and its co-investors include other development finance institutions, private investors and NGOs. Grants are used—always with cost-sharing arrangements—as a way to invest in innovative "next generation" projects.
- **Exit strategy in place and implemented.** MIF demonstrates a strong commitment to encouraging the entry of private investors. Its operations are held to a limited time horizon with the intent to exit equity investments at the earliest possible opportunity. To date, MIF has exited from over 10 institutions. It is not always easy, but much desired, to let go of successful investments and to turn to building the next generation of institutions.

Weaknesses

- **No discussion of internal resources needed to triple microfinance investments.** The vision and rationale for the ambitious strategy are well laid out. Yet, there is little analysis of MIF's weaknesses in the strategy, nor of what changes or additions are needed to support such an expansion. Creating a pipeline of operations, managing growth, and maintaining the quality of the current portfolio will undoubtedly stress MIF's staff and systems for accountability. Moreover, conditions in the markets where MIF operates are becoming more challenging with the financial crisis.
- **Little guidance on screening for additionality**. MIF's strategy calls for choosing investments where there is clear additionality. There is no evidence of practical tools and techniques for staff to do this, though supervision reports and impact evaluations call for looking at the issue. Producing development additionality—and quantifying it—is a core challenge for MIF and other DFIs. Screening investments of doubtful additionality may run against various institutional incentives, especially in a phase of three-fold expansion.
- **Specialist role beyond project design of grants not clear.** Once approved, grants are handed to country offices that are not likely to maintain microfinance experts able to properly support and monitor investments during implementation. This division of labor, combined with an institutional culture that until recently was rather disbursement focused, risks compromising the quality of the portfolio. When implementation is supervised by staff who are not fairly literate about microfinance, even projects designed by capable experts can sometimes produce disappointing results. Furthermore, the Access to Finance team's advice is not binding even during project design which may limit its ability to influence outcomes, though this does not seem to be a problem at present.
- **Insufficient engagement with country offices.** There is no evidence that the Access to Finance team is proactively reaching out to country offices to help build their skills to supervise microfinance projects. The country offices may thus be a weak link in an otherwise strong staffing strategy. Given the strategy to grow the portfolio substantially in a relatively short timeframe, staff with the capacity to monitor projects on-the-ground are essential to ensure good performance.
- **Components not captured by flagging system.** MIF's flagging system only allows for one major category per project, which means that microfinance components in larger programs are often missed. Staff estimate that less than 15 percent of the portfolio is not flagged appropriately

and thus may not receive sufficient technical attention throughout the project cycle, including supervision.

- **Performance reporting somewhat lacking.** Despite a portfolio concentrated in direct investments to financial institutions and numerous reporting templates, there does not appear to be a system in place to consolidate core performance indicators on all retail investments. Firstly, performance information on investments is collected only annually and the monthly reporting tables for microfinance investments focus more on disbursements and client outreach than on institutional performance. Secondly, information may be available at the country level with IDB staff but not necessarily flow to the Access to Finance team. Thirdly, reporting from investment funds does not include a breakdown of performance information for the retail institutions funded. As a result, there is room for performance problems to escape the notice of the MIF.
- **Nascent use of performance-based agreements for grants**. Since 2008, the project cycle clearly calls for the use of performance-based agreements with performance requirements, and disbursements based on the achievement of milestones. However, it is not clear how widespread their use is, nor if enforcement is consistent or effective.
- **Evaluations of the microfinance portfolio insufficient.** Although the MIF benefits from several reviews of the microfinance portfolio—internal management reviews, the annual development effectiveness report, and the evaluations of the Office of Evaluation and Oversight—it still does not receive external, independent portfolio reviews that focus on the performance of a broad cross-section of microfinance projects. As such, the MIF may be missing the opportunity to fully understand the performance of its portfolio, including what works well and what does not, and to include lessons learned in the design of new projects.

Recommendations

MIF has a solid track record in microfinance yet recognizes that a great deal still needs to be done to extend access to finance across Latin America. The Fund's strategy is ambitious not just in the goal of tripling the volume of the portfolio, but also in its aspiration to further diversify financial products, innovate, and enter unchartered markets. This said, compared to many other development agencies, MIF is in the relatively comfortable situation of having a fairly narrow mandate—making commercial investments in advanced retail institutions.

Strengths with regard to the quality of the Access to Finance team and instruments are commendable. But, MIF also needs to redouble its efforts to improve its systems for accountability and to clarify better the relationship with the IDB, especially at the country level, for a more seamless project cycle. The areas for improvement identified by SmartAid are in line with the overall reforms already underway more broadly within the Fund. The time is thus ideal to make concrete changes to prepare and position the MIF to successfully implement the Tripling Microfinance by 2012 Strategy.

The following suggestions emerge from the SmartAid review:

- **Define more clearly what additionality means for MIF, and develop measurement tools**. MIF's strategy includes all the right language about additionality. It also acknowledges how quickly the microfinance and funding landscapes are evolving and the importance of continued innovation. To achieve additionality while working with advanced stage retailers, MIF needs to develop concrete processes, tests, and measures that will produce some clarity about whether investments are meeting this goal. Developing such a system will certainly not be easy, but MIF could work with other DFIs to advance practice in this area.

- **Commission periodic external reviews of the portfolio.** The recently approved "thematic evaluation" provides the perfect opening to conduct a review of the on-the-ground performance of MIF's portfolio. The review could be of the whole or a significant portion of microfinance portfolio. In particular, any portfolio review should focus on whether MIF is achieving its additionality goal, as discussed in the previous recommendation.
- **Give the Access to Finance team a formal quality assurance role during implementation.** The country offices can still be in the front-line of collecting performance information from grants, but the technical specialists should receive and analyze the information. Several methods and tools can be used, including regular (semi-annual or quarterly) internal portfolio review meetings like the one done in August 2008. In this way, quick action can be taken if there are problems.
- **Introduce a few core minimum performance indicators in all monitoring and supervision tables.** The Access to Finance team has produced a good "List of Common Microfinance Indicators." Two to four of these indicators, including especially portfolio quality, are likely worth tracking for all types of investments directed to retail institutions—much like client outreach and internal rate of return—and should be included in the reporting tables. Core performance indicators should be tracked regularly, and could be requested alongside the financial information currently gathered every quarter. The indicators should be consolidated by the Access to Finance team for all investments, whether direct or indirect and stand-alone or component. Specialists should review the tables and react when anomalies occur or poor performance is evident.
- **Monitor the use of performance-based agreements (PBAs).** Since such agreements are fairly new, the Access to Finance team, working with the contracts office, should develop staff training on how to design and monitor PBAs, including what to do in cases of non-compliance. Some of the incentives already in place, like allowing cancelled funds (and costs savings) to be reallocated to a common MIF pool, are excellent.
- **Build skills of country offices.** Staff with primary responsibility for supervision should have basic microfinance literacy, even if the Access to Finance team were to have a strengthened quality assurance role during implementation. MIF should offer regular microfinance training to country office staff, including instituting a mandatory course on performance monitoring. For country offices with large or complex portfolios, staff could benefit from attending internationally recognized external training events. Organizing an access to finance retreat for all staff managing microfinance investments, perhaps on the heels of the Forum, is a good way to have face-to-face interactions, increase exposure, and improve relations with the headquarter-based technical team.
- **Solve flagging problem for components.** MIF is already aware that the flagging system does not capture components, and should take quick action to find a practical solution to this problem. Flagging components is meaningful not just because it helps establish a more complete list of investments, but because it is the only way of ensuring proper technical attention from design to implementation and supervision. Depending on the performance of the components, MIF should reassess whether this funding approach should be continued.
- **Consider making local currency loans as part of regular debt offering.** MIF has made an excellent investment in the Local Currency Fund. This is an important step for taking foreign exchange risk away from retail institutions. But, MIF's direct loans are all in hard currency and the Fund should explore more flexibility to make local currency loans.

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
	80–89	
	70–79	Good
	60–69	
	50–59	Partially Adequate
	40–49	
	30–39	Weak
	20–29	
	10–19	Inadequate
	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 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.

Authors

Alexia Latortue and Mayada El-Zoghbi, with important contributions from Heather Clark, Ruth Goodwin-Groen, Richard Rosenberg, and Barbara Gähwiler.

CGAP
1818 H Street, NW, MSN P3-300, Washington, DC 20433 USA
66, avenue d'Iéna, 75116 Paris, France
www.cgap.org, cgapbetteraid@worldbank.org