



## SMARTAID INDEX 2013

### EUROPEAN INVESTMENT FUND (EIF) OF THE EUROPEAN INVESTMENT BANK GROUP



## Background

The SmartAid Index measures and rates the way funders with an interest in microfinance work. Heads of 29 major development institutions endorsed CGAP's development of the Index.<sup>1</sup>

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. As 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 accountable 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/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/Proparco and EIF are both considered new participants because in prior rounds different units within the agencies participated.<sup>2</sup> 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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<sup>1</sup>See the Better Aid for Access to Finance meeting, 2006.

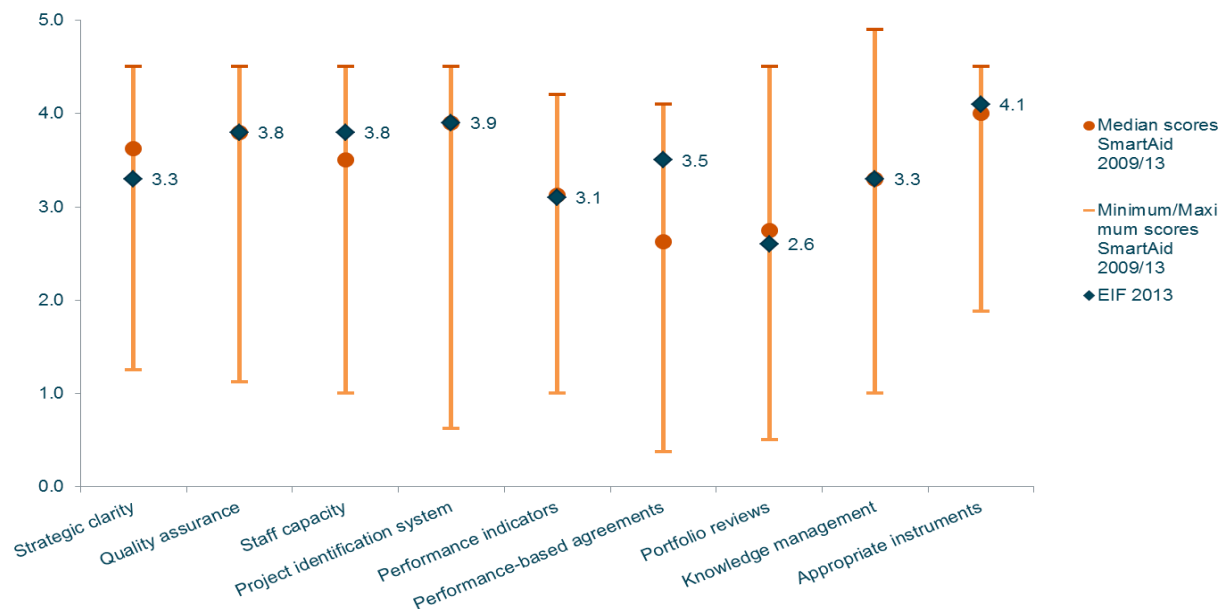
<sup>2</sup> In the case of AFD/Proparco, AFD participated in the 2009 round and the submission did not include Proparco. For EIF, two departments of the EIB Group's Directorate of Operations – Africa, Caribbean and Pacific region, and the Mediterranean region—participated in the 2011 round and did not include EIF.

## Key Findings

The European Investment Fund (EIF) received 70 out of 100 points, meaning that overall it has “good” systems in place to support microfinance. As the graph below shows, EIF received a score of 3.3 or higher—on a scale of 0 to 5—on seven out of nine indicators. Its performance on indicator 9 (instruments), was especially strong, with a score of 4.1. Scores were only slightly lower on quality assurance, staff capacity and project identification system (indicators 2, 3 and 4), and still above 3 on strategic clarity, performance indicators, performance based agreement and knowledge management (indicators 1, 5, 6 and 8). EIF’s lowest score is on portfolio reviews (indicators 7).

EIF is part of the European Investment Bank Group focusing on Europe’s small and medium enterprise sector (SMEs). EIF’s role is to develop and offer targeted financial products to partner financial institutions in the 27 countries of the European Union (EU) to enhance SME access to finance. Its strategy is aligned with the EU’s long-term vision for improving social inclusion and creating self-employment opportunities.

At a Glance	
Type of funder:	Development finance institution
Microfinance portfolio (committed as of 12/12):	\$138 million <sup>3</sup>
Microfinance as % of total portfolio:	Less than 1%
Number of projects:	31
Primary level(s) of intervention:	<input checked="" type="checkbox"/> Retail <input type="checkbox"/> Infrastructure <input type="checkbox"/> Policy
Primary instrument(s):	Grants, concessionary-priced debt, commercially-priced debt, equity guarantees
Primary source of funding:	Public funds



<sup>3</sup> The microfinance portfolio covers investments under the responsibility of the microfinance team. Commitments do not include leveraged guarantee volumes under the Competitiveness and Innovation Framework Program (CIP) microcredit window. Total leveraged guarantee exposure under CIP as of December 2012 was EUR 904 million (USD 1.3 billion).

A dedicated microfinance team was introduced at EIF in 2010. Prior to this, microfinance projects were undertaken as pilot initiatives or components under several wider SME initiatives such as the CIP. Microfinance was subsequently established as the 3<sup>rd</sup> pillar of the EIF. The core activity of EIF is to manage the European Progress Microfinance Facility (EPMF) on behalf of the European Commission and the EIB, which were both founding investors. Microfinance is also integrated in several other programs funded by the European Commission (EC) but managed by EIF, including JASMINE and JEREMIE. The EIF has an ambition to align all microfinance related activities, both technical assistance and investment, going forward (2020 perspective).

While microfinance is still relatively new and accounts for less than 1% of EIF's portfolio, there is nonetheless strong support at the highest levels of management for microfinance within the EIB Group. As part of the EIB Group, EIF benefits from this strong management support and the broader infrastructure that microfinance enjoys at the Bank. This includes knowledge exchange through the Microfinance Centre of Expertise (MCE).

### Key Strengths and Weaknesses

- **Strategic Clarity (3.3/5.0).** EIF's microfinance activities are undertaken within specific mandates that are set by the EC. To date, the primary activities in microfinance are implemented through the EPMF, which is a fund established by EIF on behalf of the European Commission (EC) and EIB as founding investors. The Facility was established to provide access to finance for specific categories of individuals excluded from the mainstream financial system (such as the unemployed, vulnerable, disadvantaged minorities). In addition to the financially excluded, the facility also supports microenterprises that are owned by or hire these excluded categories of individuals. EPMF works through intermediary institutions such as microfinance institutions and commercial banks. The facility offers primarily guarantees, loans and equity investments to eligible intermediaries. While the Facility has a prospectus which details its mission, administrative and operational structures, the prospectus is not in itself a strategy for the EIF. Other activities managed by EIF, such as Private Equity, Guarantees and various technical assistance programs such as JEREMIE and JASMINE, also entail elements of support to financial inclusion. EIF would benefit from a broad vision for how it supports financial inclusion. This vision should take into account the many legal vehicles it is able to establish, and the instruments it has as a Fund, including how technical assistance is used to complement its investment instruments. The "Progress for Microfinance in Europe" working paper can serve as an excellent basis

#### Good Practice Highlight

##### Value Added Methodology

EIF has developed a set of tools that together represent a "Value Added Methodology". The tools include an ex-ante qualitative assessment of EIF's value addition at the market level and a quantitative evaluation that measures market impact of EIF's catalytic affect. These two tools were augmented in 2010 with two additional tools: a leverage methodology which estimates the amount of third party funds mobilized through EIF signaling; and an ex-poste value added measurement tool which measures impact at the beneficiary level. Together these tools represent a comprehensive methodology or framework for EIF to estimate its value added and impact at entry and then confirm ex-poste.

for building this vision. Moreover, the vision should be based on EIF's institutional capacity, as well as the needs of the markets in the 27 European countries it covers. Given the diverse market conditions across the 27 EU countries, the strategy should articulate how it can respond to these different market needs, as opposed to being led by specific vehicles or instruments.

- **Quality Assurance (3.8/5.0).** EIF's projects are initiated and designed by the core microfinance team housed in the microfinance unit. The project review and approval process then entails a thorough analysis by the Investment and Risk Committee (IRC) prior to submission to the Board for approval. The IRC is made up of technically strong individuals across numerous functions at EIF and each division is able to present its analysis on the transaction. There appears to be considerable weight given to the risk analysis, while balanced by views of the microfinance team. Previously focusing primarily on origination, the microfinance team has increasingly taken on a larger role in monitoring. While EIF's operations manual states that debt operations are primarily managed by the risk department after origination, in practice the microfinance staff spend approximately 33% of their time reviewing monitoring reports, following up with problems incurred during implementation, and maintaining client relationships for both debt and equity transactions. With equity investments, the microfinance team often fills the board seats on behalf of EIF. Involving the microfinance team in monitoring is important for many reasons: it allows an institution to provide support to its partners to improve operational issues as they occur, rather than waiting until they appear as more serious risk-related issues; it also allows cross-learning across investments. The Microfinance Centre of Expertise (MCE), while not formally a quality assurance body, does contribute to quality enhancement by serving as a platform to discuss projects among technical specialists of all departments. Despite a relatively strong system of quality assurance, not all projects seem to receive the same amount of attention. For example, EIF's technical assistance projects and those initiated through SME windows do not go through the same rigorous process for approval as microfinance investments.
- **Staff Capacity (3.8/5.0).** EIF has a multi-disciplinary microfinance team comprised of six experts with diverse backgrounds well-suited for the type of projects it supports. EIF benefits from training and capacity development opportunities at the EIB Group for its professionals, both for its microfinance core team and for staff in other departments (risk, operations, legal, etc.). Staff have participated in several microfinance training opportunities offered by ADA and Planet Rating. EIF staff also participate in the EC annual training, the CGAP microfinance training, and a 2010 CERISE course on responsible finance. It is unclear how much EIF staff actually utilize these available resources. At its current size and operations, the staffing capacity and training opportunities are commensurate with the needs of the organization, but would need to continue to evolve in parallel with planned growth in microfinance investments.
- **Project Identification System (3.9/5.0).** Nearly all projects that involve microfinance are housed under the same team within EIF, which enables the unit to capture almost all microfinance projects. However, the organization relies on three separate information systems for different instruments. Information on microfinance projects must be consolidated. While the current system may miss projects initiated under the SME or TA windows, or older projects, these projects are in the process of being consolidated under the microfinance team and as such the system has not been modified in this interim period.

- **Performance Indicators (3.1/5.0).** EIF's monitoring systems involve quarterly surveillance reports on financial performance of its partners and semi-annual analysis of the consolidated portfolio. These reports are submitted to the IRC for review. As part of its compliance checks on the targeting of its funds, EIF tracks a set of indicators at the firm and borrower level. While this appears to be a requirement from the EC, it is not evident that this type of data can actually contribute to an understanding of social performance of the institutions with whom EIF partners. EIF collects some information on the institutions it supports, such as average loan size and average loan maturity, and client type. However, it may still be missing important information on the practices and performance of institutions it supports, such as clear social performance management of mission aligned with operations, as advanced by the Universal Principles for Social Performance Management, including the integration of the Smart Campaign client protection practices. A better understanding of the social orientation of investees can offer insight on overall institutional performance in relation to peers and demonstrate the importance of MSME finance in relation to other client segments for the partner. By tracking performance over time, analysis can also show if EIF support is encouraging stronger social orientation by the partner.
- **Performance-based Agreements (3.5/5.0).** EIF's contracting includes some performance-based elements, such as funding in tranches upon completion of certain agreed conditions by the partner. Also, financial covenants are checked quarterly to ensure institutions comply with stipulated agreements. An interesting penalty used for non-compliance involves an interest rate step-up when targets are not met. The trigger conditions are currently set primarily based on loan volumes and some business process enhancements—such as completion of a business plan, as well as some performance indicators such as levels of non-performing loans or efficiency indicators. Lending volumes, particularly in developed markets where access to consumer credit is often prevalent, may not lead to the desired incentives for financial institutions. Some markets of Central and Eastern Europe have suffered from elements of multiple borrowing by clients. This has later resulted in over-indebtedness for the borrowers and lower portfolio quality for the financial services providers. When setting performance conditions in its agreements, EIF should be cognizant of the market conditions and the outcomes it seeks to induce, which will necessarily differ across the vary diverse markets in which EIF operates. One notably useful target that EIF includes in its agreements relates to leverage. Often partners are expected to leverage from 1 to 5 times the investment value placed by EIF.
- **Portfolio Reviews (2.6/5.0).** As a relatively young entrant into microfinance, EIF has yet to undertake a full review of its microfinance portfolio. The semi-annual internal portfolio reviews compiled for IRC, which include value-added analysis, provides a good opportunity for an internal snapshot of the portfolio performance, and a chance to suggest follow-up action such as acceleration, work out or impairment. Generally, the focus of this type of review is to correct action as pertaining to loan recovery, as opposed to improving project design. EIF's commissioned Impact Investment Framework is a very promising indicator of EIF's potential foray into developing tools and systems to assess its programs. This document provides excellent proposals regarding value added methodology to assess additionality. Tools such as the Value Added Scorecard are also notable and demonstrate an institutional thoughtfulness to ensuring that investments contribute toward market outcomes. EIF is planning a portfolio review in 2013 within the context of its mid-term review.

- **Knowledge Management (3.3/5.0).** EIF's team responsible for microfinance is relatively small and all based in Luxembourg, allowing the team to benefit from direct interaction and knowledge exchange through day-to-day activities. EIF supports an intranet on which project documents and other tools can be shared across the organization. There are established internal meetings that serve as opportunities for knowledge exchange such as the bi-weekly pipeline management meetings. As part of the EIB group, EIF benefits from the Microfinance Center of Excellence platform, which meets twice a year and provides a forum to discuss projects in the pipeline across the Bank and exchange lessons learned at the project level. Perhaps because it is still a relatively small team, the focus to date has been very transactional when it comes to knowledge management. Other knowledge around good practices or specific topics related to financial inclusion are not yet supported. Overall, there is no broad knowledge management strategy or system. Also, it is not clear whether EIF has thought through or identified the types of areas in which it aims to grow. Finally, there is no explicit knowledge management budget for learning events or opportunities, although there is some training budgeted for staff development.
- **Appropriate Instruments (4.1/5.0).** EIF has a full range of instruments (debt, equity, guarantees at the client level and hybrids) with flexibility to modify terms, prices and incentives to meet the goals of the investment and to encourage the crowding-in of private investors. It applies sound market pricing, can finance in local currency, and has well-articulated exit strategies. It also recognizes the importance of capacity building and supports these efforts where possible. The institution has a clear analysis of its goals to leverage funding and measures value addition. EIF does not have any credit components but funds stand-alone financial inclusion programs, many of which are focused on building the funding market in the countries in which it works. While EIF is very thoughtful about its value addition, it does offer guarantee products free of charge raising questions about potential market distortion. EIF's guarantees are either at the portfolio or the client level. When structured on a portfolio basis, EIF uses the guarantee as a way to leverage private investment into its MFI partners, although the specific analysis used to determine pricing to attract private investors is not clearly articulated. When structured at the client level, MFIs must demonstrate increased risk taking such as increased outreach to underserved segments or a reduction in their collateral requirements. As the *raison d'être* behind MFIs is to reach underserved market segments, it is not clear how the guarantees push the frontier further beyond the existing business models of MFIs. Additionally, there appears to be a focus on volume of lending and equity placements, albeit alongside a focus on building markets. As EIF intends to take a future leading role in capital market building, more research might be devoted to how best to influence the variety of public and private investors active in these markets, and using it to actively crowd-in private investors.

## Recommendations

EIF benefits from a strong parent company, the EIB Group, which has clear operational systems and strong staff capacity. EIF has invested in building a strong team that manages its microfinance operations and has put in place a suite of instruments that allow it to support different markets across the European Union. As its portfolio has grown in microfinance, EIF has developed proportionate internal systems which allow it to manage and support its microfinance investments and technical assistance projects. EIF should continue to

invest in its operational systems to support continued growth and evolution of its portfolio to respond to market dynamics across the region.

The following suggestions emerge from the SmartAid review:

- **Identify strategy for microfinance beyond EC mandates.** EIF's microfinance operations fall under different mandates. While this might make sense due to the sources of funding, it should not prevent a strategic vision for EIF as a whole, with guidance from the results of a SWOT analysis. Given the significant differences that exist in the markets across Eastern and Western Europe, EIF's strategy can differentiate how it addresses significant market differences in these two sub-regions through the use of different instruments or programs. For instance, in Eastern Europe where the financial systems are far less developed and where much larger numbers of individuals are excluded from the financial system, the strategy should articulate support to the broader segments of excluded populations in these markets. In Western Europe, where exclusion is more of an economic and social phenomenon and not simply a financial one, EIF should articulate how its support can address these broader structural issues and where targeting of specific segments may help address issues of exclusion.
- **Incorporate portfolio review analysis in upcoming mid-term review.** As a relatively new activity within EIF, there has been no portfolio review undertaken on EIF's microfinance projects, whether investments or technical assistance. With growing experience and now poised to expand, EIF could benefit from reflection on what its projects have achieved to date and how this may influence its activities moving forward. Understanding performance to inform future project design is a hallmark of a learning organization. A portfolio review should analyze all microfinance projects or a significant important sub-section of the portfolio. It should look at underlying performance information of the institutions in which EIF is investing. In addition, the portfolio review should analyze EIF's own inputs and value added and the projects' attainment of their objectives to draw lessons learned which can be used to articulate EIF's future strategy in advancing financial inclusion. While EIF is currently planning a mid-term review which will include portfolio analysis, it should ensure that this review follows a methodology that enables it to extract lessons from its portfolio.<sup>4</sup>
- **Invest in institutional learning through strong knowledge management.** EIF appears to rely heavily on EIB and the EC for knowledge management activities. Given the high quality of these activities, EIF should continue to benefit from access to these opportunities. However, this should not limit EIF's reflection on its own needs and investing in the types of specific knowledge and learning requirements for the markets in which it works. For example, given the nature of markets in Western and Eastern Europe, it is likely that more knowledge on social exclusion would be of greater relevance for an institution like EIF than for funders working in developing markets, where financial exclusion is more broad-based. Issues related to entrepreneurship and competitiveness may also be of more significance for EIF than for other funders given the nature of business and entrepreneurship in Europe as compared to the developing world. As in all things, maintaining a focus that is supported by a budget and staff time can help move EIF's already great progress toward that of a learning organization.

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<sup>4</sup>Please review CGAP's technical guide "Portfolio Reviews Resource Guide for Funders," December 2012.

- **Rationalize and streamline the types of performance indicators tracked.** EIF's focus on meeting EC mandates has meant a heavy burden of data collection at the end-client level. While this is a requirement from the EC, it is institutionally cumbersome and there are serious questions as to its effectiveness in understanding institutional social performance issues. EIF should negotiate with the EC to develop a more rational sampling methodology to confirm segments reached, but the bulk of the performance monitoring should ideally be focused at the institutional level, not at the end client level.
- **Analyze the application of performance-based agreements.** EIF's agreements may be unintentionally incentivizing disbursement rather than performance. EIF may want to invest in analyzing this more closely to ensure that its partners are making decisions that reflect sound market growth and meet client needs, rather than reaching targets for receipt of funding tranches.
- **Ensure quality assurance systems provide technical input for all types of EIF microfinance activities.** EIF's current quality assurance processes are segmented into two components: analysis of financial risk and monitoring of loans to end-clients. Improvements in the identification and monitoring of indicators focused on social performance of the institutions (see recommendation above) can strengthen the microfinance team's monitoring and support provided to investees. Expanding quality assurance to technical assistance projects, and not just transactional activities, would also provide a more holistic market intervention approach for EIF.



## 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.

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

<b>SmartAid Index Indicators</b>			
<b>Strategic Clarity</b>	<b>1</b>	Funder has a policy and strategy that addresses microfinance, is in line with good practice, and is based on its capabilities and constraints.	<b>15 points</b>
<b>Staff Capacity</b>	<b>2</b>	Funder has quality assurance systems in place to support microfinance projects and investments.	<b>10 points</b>
	<b>3</b>	Funder has the staff capacity required to deliver on its microfinance strategy.	<b>15 points</b>
<b>Accountability for Results</b>	<b>4</b>	Funder has a system in place that identifies all microfinance projects and components.	<b>10 points</b>
	<b>5</b>	Funder monitors and analyzes performance indicators for microfinance projects and investments.	<b>10 points</b>
	<b>6</b>	Funder incorporates performance-based elements in standard agreements with partners.	<b>10 points</b>
	<b>7</b>	Funder regularly reviews the performance of its microfinance portfolio.	<b>10 points</b>
<b>Knowledge Management</b>	<b>8</b>	Funder has systems and resources for active knowledge management for microfinance.	<b>10 points</b>
<b>Appropriate Instruments</b>	<b>9</b>	Funder has appropriate instrument(s) to support the development of local financial markets.	<b>10 points</b>
<b>MAXIMUM SCORE</b>			<b>100 points</b>

### 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)

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