



SMARTAID FOR MICROFINANCE INDEX 2011
UNITED NATIONS CAPITAL DEVELOPMENT FUND (UNCDF)



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.

Six funders— AusAID, EIB, GIZ, KfW, MIF and UNCDF —participated in SmartAid 2011, increasing the total number of funders participating in the SmartAid Index to 18. Prior rounds have included the participation of AECID, AFD, AfDB, AsDB, CIDA, EC, FMO, IFAD, IFC, ILO, SDC, and Sida. Four agencies from the 2011 round had participated in prior SmartAid rounds (GIZ, KfW, MIF, and UNCDF). 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.

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

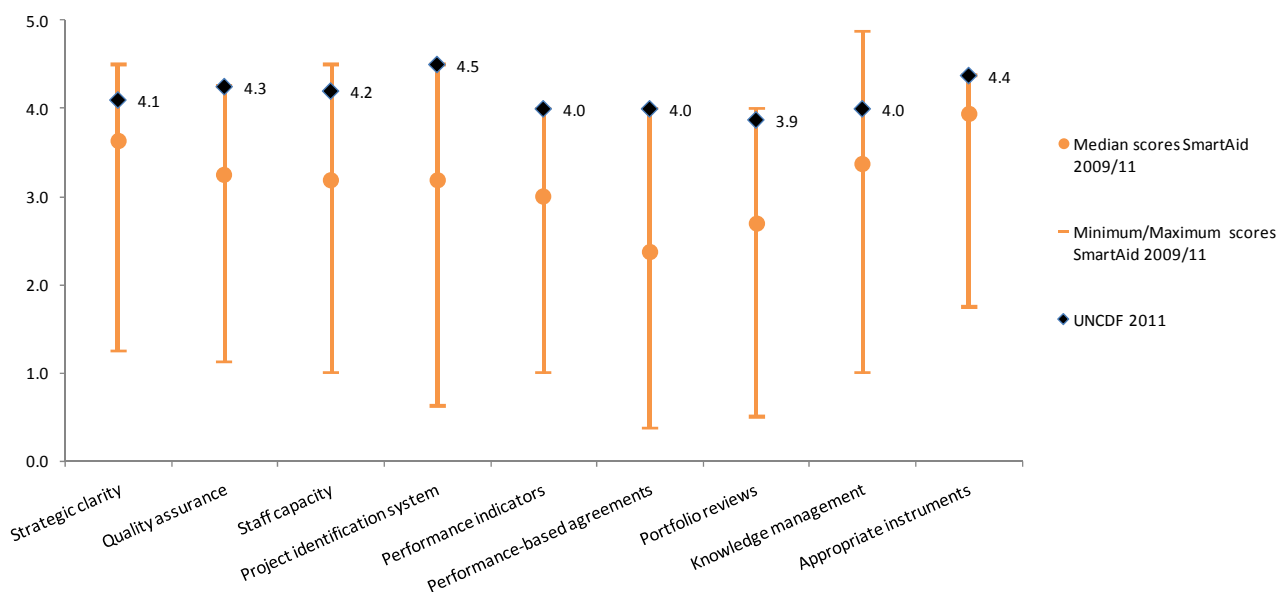
Key Findings

UNCDF received 83 out of 100 points, meaning that overall it has “very good” systems in place to support microfinance. UNCDF increased its score by 10 points since its participation in SmartAid 2009 thanks to significant improvements of its internal systems over the last two years. As the graph below shows, UNCDF scored above 4, on a scale from 0 to 5, on all indicators except indicator 7 (portfolio reviews). On indicator 5 (performance indicators) and indicator 9 (appropriate instruments) UNCDF received the highest scores compared to other agencies participating in SmartAid 2009 and 2011. On quality assurance, project identification system and performance-based agreements (indicators 2, 4 and 6) UNCDF is on par with the highest scores reached in SmartAid so far.

At a Glance	
Type of funder:	Multilateral/UN Agency
Microfinance portfolio (committed as of 12/2009):	\$45 million
Microfinance as % of total portfolio:	50%
Number of projects:	22
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

UNCDF provides investment capital and technical advisory services to support development in the Least Developed Countries (LDCs). It was set up as a special purpose fund of the UN and is affiliated with the United Nations Development Program (UNDP). UNCDF has two distinct business lines: microfinance and local development. The Financial Inclusion Practice Area (FIPA) manages a country program portfolio and global thematic initiatives on South-South expansion of MFIs (MicroLead) and financial services for youth (YouthStart). UNCDF counts on strategic partnerships to expand its portfolio and develop new initiatives, for example on microinsurance with ILO and on remittances with IFAD. UNCDF’s specialization on microfinance, its ability to work with partners and its flexible hiring structures allow it to respond quickly to

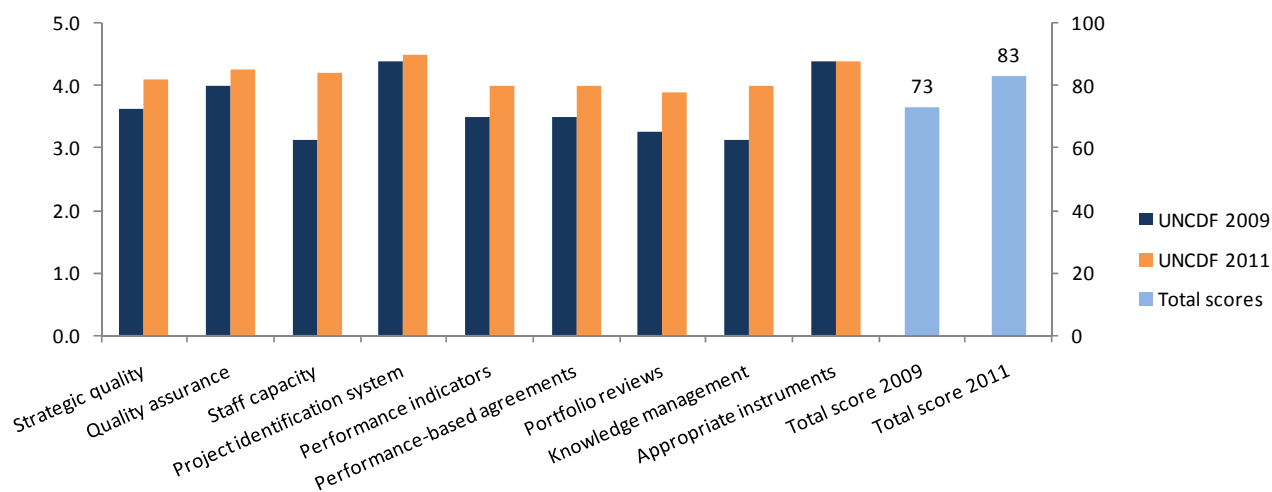
UNCDF Scores



demand and market needs. While it is well placed to develop and pioneer new initiatives, it should be cautious not to lose sight of its core strategy and overstretch its range of activities beyond its capacity.

UNCDF has introduced numerous reforms within FIPA, in line with the recommendations from the last SmartAid round. It clarified its “facilitator” and “investor” roles and has a new business plan for FIPA. UNCDF’s staff has grown significantly over the last two years, requiring additional improvements in internal knowledge management systems. UNCDF made a major investment in a new intranet, MyUNCDF, and adopted an agency-wide knowledge management strategy. With the planned 2011 portfolio review, UNCDF will be taking the next major step to distill learning from its experience.

UNCDF scores SmartAid 2009 and 2011



Key Strengths and Weaknesses

- Strategic Clarity (4.1 /5.0).** UNCDF endorsed an agency-wide 2010-2013 Corporate Management Plan (CMP) with clear strategic objectives and reviews its binding Operations Manual annually. The Business Plan for FIPA, rooted in the CMP, was updated based on the results of SmartAid 2009 and an evaluation of UNCDF’s regional program in Africa (BIFSA). The BIFSA evaluation resulted in a strategic shift from national microfinance strategies to a broader financial inclusion approach that goes beyond microfinance. Recognizing its comparative advantage for support at the retail level, UNCDF has redefined and narrowed down its role at the meso and macro levels. In a thorough management exercise, UNCDF reviewed its role as a facilitator, which focused in the past on creating and facilitating national microfinance strategies. As a result, UNCDF will henceforth focus on developing country-level diagnostics with the creation of a standardized tool in partnership with FinMark Trust. It also clarified its investor role at the retail level, paying due attention to the set-up and governance of local Investment Committees that are put in place by UNCDF to coordinate funding at the country-level.

The new strategy was discussed in a week-long retreat with all staff; however, the transition to the new financial inclusion approach will require continued efforts. As duly recognized by UNCDF, ensuring cohesion between country-level sector development programs and global thematic initiatives remains a challenge.

UNCDF's small core budget and structure requires leveraging funding from partners. The extent to which UNCDF support leverages additional capital flows is defined as a key success indicator in the CMP. While this underlines UNCDF's role as a catalyst, there is a clear risk that it might result in growth led by partnership opportunities rather than strategic vision.

- **Quality Assurance (4.3/5.0).** The UNCDF Operations Manual defines a clear appraisal process for country-level programs. A local project appraisal committee (LPAC) checks that all relevant local stakeholders endorse projects and an appraisal committee at headquarters (HQPAC) ensures compliance with UNCDF's strategy and operational guidelines. Comments or changes to the project design must be approved by both committees before the UNCDF executive secretary commits funding to a project. The FIPA director is a member of the HQPAC and is responsible for implementing amendments to project documents in case the committee made significant comments. Also, any project including a microfinance component, whether originated by FIPA or by the Local Development practice area, must be approved by the headquarters Inclusive Finance Investment Committee. Projects are designed by technical staff at headquarters, regional offices or country offices. A recent decision to reallocate administrative work from technical specialists to operations staff frees time for microfinance specialists in regional centers and country offices to focus on technical work. Their responsibility for quality assurance has been strengthened in the job descriptions.

Quality assurance processes for country-level programs are very solid. However, the gradual decentralization and addition of many new staff will likely require an adaptation of the general quality assurance processes and quality assurance systems within the thematic initiatives.

- **Staff Capacity (4.2/5.0).** The SmartAid 2009 report identified a mismatch between UNCDF's ambitious strategy covering all three levels of the financial system and the expertise of its staff. Since the last round UNCDF has taken action on both fronts. Firstly, it has narrowed down its work at the market infrastructure and policy levels. Secondly, UNCDF increased its staff capacity: a policy advisor was hired to oversee work on policy, advocacy and client protection. UNCDF has also considerably increased the number of specialist staff at headquarters, in regional offices (Dakar, Johannesburg and Bangkok) and in country offices. The team is expected to increase further, as several positions are still open for recruitment. Once established, the new thematic areas will be staffed with additional technical specialists. Given its flexible procurement system, UNCDF can easily hire external consultants to complement its internal capacity.

Recognizing its comparative advantage in strong technical competence, UNCDF invests significantly in staff development. Strengthening its ability to develop a talented workforce is part of the strategic

Good Practice Highlight

MyUNCDF – Intranet in the Facebook era

MyUNCDF is a state-of-the-art intranet platform that gives staff access to internal resources, project documents, contacts and infotainment, such as an interview with UNCDF's Executive Secretary David Morrison. Every staff has her/his profile online and a chat function serves as an informal forum for exchange among staff located in offices around the world. The platform is easy to use and staff can create their own content related to their projects and their unit. MyUNCDF seems to make document management more efficient and even less tedious.

objectives defined in the CMP. UNCDF has undertaken a training needs assessment for staff and as a result it has sent several staff to external trainings such as the Boulder Microfinance Program. Nevertheless, staff capacity in some regions still lags behind and skills are not necessarily concentrated in the offices with the largest project portfolios. Country Technical Advisors (CTAs) have to assume new responsibilities in topics covered by the thematic initiatives, but it is not clear how well they are equipped and trained to do that.

- **Project Identification System (4.5/5.0).** UNCDF's Atlas database can generate a list of all projects anytime. Projects are assigned a code depending on the department that manages them. As microfinance is one of only two practice areas at UNCDF, identifying the microfinance portfolio is relatively straight-forward. Atlas keeps track of all financial transactions and all major project documents have to be uploaded to the system. Training on Atlas is available to staff. The Operations Manual includes clear guidelines on what needs to be entered into the system, however, it does not explain how codes are assigned.
- **Performance Indicators (4.0/5.0).** UNCDF recently established an online platform for performance information called Financial Inclusion Online (FIOL), which is accessible to all staff and external guest users. Partners are required to report quarterly on standard performance indicators which were developed in cooperation with the MIX and include outreach, poverty, sustainability and operational efficiency indicators. UNCDF tracks whether quarterly reports are sent on time, and on-time reporting is currently at an impressive rate of 93%. FIOL consolidates performance information of supported financial service providers per country and provides a good overview of how these institutions perform compared to their peers. UNCDF analyzes the data to check whether projects meet their targets, which is reported in an aggregated form in the Annual Report. However, there is no analysis of the standard performance indicators across the portfolio, which is clearly a missed opportunity given that the data is available. Comparing the performance of institutions across different countries or even regions could help identify trends or adverse market developments. UNCDF has started defining indicators for its projects at the market infrastructure and policy levels, but no standards have emerged so far.
- **Performance-based Agreements (4.0/5.0).** UNCDF has made significant improvements in the use of performance-based agreements since the last SmartAid round, which is reflected in a 0.5 increase of its score on indicator 6. UNCDF has model grant agreements that require the definition of performance targets and disbursement conditions. Performance indicators are standardized, but there is flexibility in adapting performance targets to the supported microfinance institution. An operational guidance note helps staff define targets and specifies who is responsible for monitoring and for enforcement in case of non-compliance. Also, the Client Protection Principles have been integrated into standard agreements. UNCDF has integrated learning from its past experience with enforcement letters and has introduced new guidance to help staff enforce performance-based agreements. A checklist helps staff decide whether the disbursement conditions are met, and a waiver system was introduced for cases where disbursement is justified in spite of missing performance targets. UNCDF analyzes the achievement of performance targets and has a good overview of how many of its projects are underperforming.

UNCDF seems to have overcome its reluctance to suspend funding for financial service providers that do not comply with performance targets. This practice is still new and while the operational guidance

note clarifies responsibilities, there is little actual guidance on how to evaluate, when to suspend funding and when to grant a waiver. While grant agreements are strongly performance-based, this is not the case for loan agreements. Also, initial thinking about performance-based agreements with meso and macro level actors has yet to be implemented.

- **Portfolio Reviews (3.9/5.0).** UNCDF's microfinance portfolio was reviewed in 1998 and again in 2005 as part of a larger UNDP portfolio review. In addition, UNCDF undertook thematic reviews such as the evaluation of MicroStart and BIFSA (Building Inclusive Financial Sectors in Africa). UNCDF's evaluation policy requires outcome, program and project evaluations. The portfolio reviews are not only accessible to staff, but also shared on public platforms such as the Microfinance Gateway. UNCDF takes evaluation results seriously and discusses the findings at its internal retreats. Management reviews and prioritizes the recommendations made by evaluators and takes action to implement them. Progress against strategic management objectives is communicated in the Annual Report. The different reviews and evaluations have indeed lead to major strategic and institutional improvements within UNCDF. Following a recommendation made in the SmartAid 2009 report, UNCDF is currently in the process of designing a new review of its microfinance portfolio. The review covers both the country-level programs and the thematic initiatives, and it presents an excellent opportunity for UNCDF to compare the performance of those two different approaches. So far, evaluations and reviews have not focused on the quality of UNCDF's input or its value added, which this review should certainly address.
- **Knowledge Management (4.0/5.0).** UNCDF has invested significantly in its knowledge management systems since the last round of SmartAid, resulting in a 0.9 point increase on indicator 8. The new intranet, MyUNCDF, is a powerful tool for knowledge sharing and document management. It is bi-lingual, user-friendly and features a chat function that facilitates exchange among staff. Policies, manuals, the UNCDF Newsletter and project documents are easily available thanks to a clear "Document Management and Classification Policy". UNCDF hired a knowledge management focal point and developed a knowledge management strategy that is anchored in its CMP. UNCDF invited GIZ, an acknowledged leader on knowledge management, to a corporate retreat where it provided input for the development of the strategy. The corporate strategy was translated into a concrete four-year staff development and knowledge management plan for FIPA. UNCDF holds regular calls to ensure communication flows between regions, country offices and headquarters, and all staff comes together at an annual retreat. UNCDF's progress on knowledge management is impressive; what remains to be seen is how the new knowledge management strategy will be implemented and how staff will take up the new systems. Fostering learning between country-level programs and thematic initiatives will become increasingly important.
- **Appropriate Instruments (4.4/5.0).** UNCDF's flexible grant instrument is well adapted to its strategy and its focus on LDCs. Under its mandate UNCDF works directly with the private sector and aims at building sustainable financial service providers. UNCDF can also make loans, which makes it unique among UN organizations. However, this instrument is rarely used and when it is used, it is usually linked to capacity building grants. Reliant on partnerships and external funding, UNCDF articulates well its comparative advantage and the "value for money" of its programs. Leveraging additional funds from other donors is an integral part of its business model, which defines UNCDF as a catalyst. The recent operational guidelines on UNCDF's facilitation and investment roles also help clarify UNCDF's delivery

model and the use of its instruments. UNCDF policy prohibits credit components in the Local Development program, UNCDF's second practice area. While strong safeguards are in place to prevent this, vigilance is still required, particularly with increased decentralization and staff expansion. UNCDF's Vision and Mission Statement includes key principles to avoid market distortions and to leverage commercial sources of funds when using subsidies. However, the mechanisms to check whether these principles are respected could be strengthened.

Recommendations

UNCDF has a clear focus on pushing the frontiers of financial inclusion in some of the most difficult markets. It is well equipped to deliver on this strategy, having the technical staff capacity and the instruments in place to support financial service providers in LDCs. Major steps have been taken to enable UNCDF to learn from its past experience and this learning is accessible to staff throughout the institution. UNCDF's commitment to improving the effectiveness of its systems is exemplary and the responsiveness to recommendations made through SmartAid and other external or internal evaluations is impressive. Given the recent strategic reorientation and the fast pace of institutional change, it is now time to focus on implementation, observing how staff takes up the new systems and exploring what is working and what needs refinement.

The following suggestions emerge from the SmartAid review:

- **Ensure that new partnerships are aligned with strategic priorities.** Partnerships are an excellent way to seize new opportunities and develop additional areas of work. However, UNCDF should make sure new initiatives fit within its strategic framework and do not over-stretch the capacity of its staff, especially in regional and country offices. The coherence between the country-level sector approach and the thematic initiatives still requires some more thinking at a strategic level, but most importantly, UNCDF should address how the new approach is implemented and how to facilitate staff uptake.
- **Use full potential of portfolio review.** The 2011 portfolio review is a great opportunity for institutional learning. UNCDF should make sure the review looks both at the underlying performance of financial service providers and the quality of UNCDF's inputs. Also, the review should be able to answer questions regarding the effectiveness of country-level programs compared to projects managed within the thematic initiatives.
- **Strengthen performance-based elements in loan agreements.** Grants, UNCDF's primary instrument, are performance-based. However, performance incentives in UNCDF's loan agreements could be strengthened. UNCDF's loans are concessional and mid- to long-term, and UNCDF uses them as a mechanism to test a financial service provider's financial sustainability. Including financial and social performance targets in loan agreements would better serve this purpose.
- **Clarify use of grants for financing the portfolios of financial service providers.** UNCDF uses grants to provide seed capital and technical support. In a few cases, loans are used to finance financial service providers' loan portfolios. Given that UNCDF can make concessional loans and takes considerable risk, it should clarify when the use of grant funding for financing portfolios is justified, and when a loan better fits this purpose.

Methodology

SmartAid distills learning from over nine 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 and 2011 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 and 2011 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

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

About CGAP

CGAP is an independent policy and research center dedicated to advancing financial access for the world's poor. It is supported by over 30 development agencies and private foundations who share a common mission to alleviate poverty. Housed at the World Bank, CGAP provides market intelligence, promotes standards, develops innovative solutions, and offers advisory services to governments, microfinance providers, donors, and investors.

Funders participating in SmartAid to date

Agencia Española de Cooperación Internacional para el Desarrollo (AECID), Agence Française de Développement (AFD), African Development Bank (AfDB), Asian Development Bank (AsDB), Australian Agency for International Development (AusAid), Canadian International Development Agency (CIDA), European Commission (EC), 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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