Policy letter Partos Programme evaluation Microfinance sector

Subject: Programme evaluation Contribution of CFAs to the Microfinance sector, 2003 - 2007

From: ICCO, Hivos, Oxfam Novib, Cordaid

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1. Introduction

An external programme evaluation of Cordaid's, Hivos', ICCO's, and Oxfam Novib's contribution to the Microfinance sector for the period 2003 – 2007 was carried out by the ECORYS – Carnegy – EOS – Evaluatiegroep consortium, led by ECORYS.

The aim of the evaluation was to gain insight in the extent to which these Co-Financing Agencies (CFAs) have contributed to building sustainable and socially performing MFIs during the period 2003 – 2007, for the sake of accountability and to draw lessons for the future.

The evaluation had many components: a portfolio analysis, literature study, a study of the policies of the four CFAs, a detailed desk study of a sample of 50 selected partners in 5 countries and a detailed field study of cases out of this sample in four of these five countries.

CFA's general opinion on the quality of the Programme Evaluation

The evaluation took considerable time, but resulted in a solid and extensive report. The study provides very useful recommendations for the CFAs to improve their policy and practice regarding the support to the microfinance sector.

The CFAs do regret the lack of analysis by the evaluators of the differences between the four CFAs in their support to the MFI (Microfinance Institution)-sector, and of a more explicit attention for this in the (synthesis) report. We do acknowledge that this was not explicitly stated in the ToR, but it was already noticed as a shortcoming in a very early instance by the CFAs and discussed with the evaluators. The four CFAs differ considerably in the management of financial instruments, with CFAs handling all microfinance–related activities in house, and those which delegate the more advanced financial services to specialised intermediaries.

Opinion of the ERG on the quality of the Programme Evaluation

According to the assessment of the External Reference Group (ERG) of the quality of the evaluation, the report addresses the evaluation questions in a systematic way that is based on a sound analysis, the methodology is described well, and limitations are acknowledged. Some limitations such as the assumed applicability of the CGAP graduation model to all CFAs, a limited validity of the Financial Self Sustainability[1] (FSS) as indicator for MFI progress (and the large fluctuations in this indicator), and the impossibility to really measure the poverty focus of MFIs, are not fully reflected in the conclusions. Also the evaluation should have contained more critical analysis of the intervention theory, especially with respect to a) CFAs having explicit and different policies, yet no significant differences in their portfolios and to b) the observed lack or absence of graduation of MFIs. Both should have given rise to more analysis of the causes of these findings. The CFAs agree with this assessment of the ERG.

2. Conclusions of the Programme Evaluation

The CFAs invested a total of EUR € 185 million in the period 2003 – 2007 with a total number of 649 partner organisations, in 72 countries. In Micro finance instruments are used such as loans and guarantees. All CFA's focus on poverty alleviation as a final objective.

The evaluators conclude that without doubt the CFAs contributed to building sustainable and socially performing MFIs. The evaluation revealed furthermore that all partners of the CFA's have a clear and explicit focus on the poor which is not negatively affected by efforts to increase operational and financial performance. The social charter of the MFI partners largely coincides with the aims of the CFA's, as advised by CGAP. The evaluators conclude that the CFAs provide financial services to people having no access to the regular financial institutions. The four CFAs have supported a large number of MFIs to increase the size of their operations significantly. The expansion of the CFA support to microfinance went hand in hand with the professionalisation of these activities within the CFAs. The supported MFIs, as said, indeed serve the productive poor and aim for increased female participation. The CFAs also support relevant network and lobbying organisations in microfinance that have a clear added value in improving the enabling environment.

Next to these positive conclusions about the poverty focus and the way the CFA's support the MFIs, the study shows there is room for improvement on other issues. Some critical comments are made on the contribution of the CFAs, such as lack of attention to support MFIs in developing efficiency risk management and commercial viability. CFAs still search for the right instruments to deal with governance issues of the MFIs. Additionality is an issue of concern that has to be addressed. Regarding poverty focus the concept 'poor' is restricted to economically active poor, mostly in urban or semi-urban settings. In Africa, women participation both within the MFIs and among clients is disappointing.

From the analysis and recommendations of the evaluation group, the CFAs have formulated the following answers and actions.

[1] The aim of support to MFIs is to get them profitable, i.e. their costs should be covered by the income (returns) from the loan portfolio. We distinguish Operational Self Sufficiency (OSS) in which a MFI covers the costs of personnel, administration, losses of the portfolio due to bad loans and interest to be paid over debts and Financial Self Sufficiency, which refers to the situation that the MFI also covers costs related to inflation and attributed costs of the equity and assets like land and buildings.

3. Recommendations and lessons learned from the Programme Evaluation

Poverty focus of MFIs

The evaluators conclude that the MFIs provide financial services to people having no access to the regular financial institutions. The profile of the clients of all MFIs is that of the "productive poor" or "economically active poor", but they do not restrict themselves fully to the poor. The evaluation concludes that the latter has not gone to the detriment of the original target group of "productive/economically active poor". The poorest, i.e. the jobless and the landless are not served.

The last two years the CFAs have been reflecting on their role within the MFI sector. As development organisations we see microfinance as an important strategy for poverty alleviation and the reduction of vulnerability of poor people (households below the food security line, displaced people, HIV/AIDS victims). We therefore need to focus more explicitly on groups and regions that thus far haven't been (sufficiently) reached by the microfinance sector, and support the development of products and services based on the needs of these groups. At the same time we should be aware of negative trends in the microfinance sector, like the strong focus on maximizing profit (to the detriment of clients) and the high costs of available products, which lead to high debts of clients. Three members of MicroNed[2] support the website www.mftransparency.org that publishes the costs that MFIs charge to their clients, hoping to generate more consciousness among MFIs and putting pressure on them to lower the interest rates. More attention for the protection of clients and emphasis on social return and social impact are therefore crucial.

The report concludes that the MFIs are still lacking in their attention for social performance. This is a correct conclusion for the evaluated period, but the last two years (2008 – 2009) investments have been made to convince the MFIs of the importance to monitor social performance and to support them to set up systems to measure social performance. There is still a lot to be done, and an important role for the CFAs is to keep social performance measurement on the agenda for the coming years.

The CFAs in the framework of Microned, are reviewing their gender policies with the aim to implement a more effective gender policy in the area of micro finance.

Regarding the measurement of social performance of MFIs we can report that the Social Performance Working Group of MicroNed is actively involved in putting social performance on the agenda of MFIs. Social Performance Management is becoming an integral part of MFI management.

Operational and financial performance of MFIs

MFIs which are neither Operationally Self Sustainable (OSS) nor Financially Self Sustainable (FSS) belong to segment A, operationally sustainable but not financially sustainable MFIs belong to segment B, whereas financially and operationally sustainable MFIs belong to segment C. This so-called A-B-C seg-

[2] MicroNed was created in 2006, as a network of the Dutch Development Finance Organisations Cordaid, Hivos, ICCO and Oxfam Novib, to cooperate on a structural basis with respect to the establishment of a specialised sector approach for microfinance. In 2008 Rabobank Foundation joined MicroNed.

mentation, a segmentation which is based on indicators of financial and operational self sufficiency of MFI's has proven to be a rather useful evaluation tool. The evaluators also conclude that it is a potentially good tool for CFAs for decision making on application of funds and modalities. The evaluation concluded that overall the financing tools applied by the CFAs are adjusted to the status and corresponding needs of the beneficiary MFIs. However, the evaluation also found some exceptions to this rule and concludes that the use of grant funding to support relatively mature partner MFIs is not always sufficiently justified and that exit strategies from segment C organisations have been rarely applied.

Even though the study speaks of exceptions to the rule, the CFAs would like to respond to this issue because of its importance. The CFAs are of the opinion that the A-B-C segmentation shouldn't be handled too strictly. In its simplicity (or straight-forwardness) – looking only at OSS and FSS – this yardstick (or instrument) makes it possible to measure 'progress'. However, during the evaluation it became clear that OSS/FSS are rather crude indicators for 'MFI progress'. Some MFIs are balancing around 100% FSS and yet cannot be considered 'strong' MFIs. There is no linear development from A to B to C. Another argument for not handling the A-B-C segmentation too strictly, is that more dimensions should be taken into account, such as the quality of the management, quality of internal control, movements in the quality of the loan portfolio, etc. The CFAs consider it justified to provide a grant support to segment C MFIs , which are considered weak in these other dimensions. Another reason for grant support to this category of organisations is their assumed potential for innovation, development of new products and services, and the focus on clients and regions with a high risk profile. The segment C MFIs could play the role of pioneer. The results of these pilots and innovations can be shared with a broader range of MFIs nationally of internationally.

Having stated the above, the CFAs do take the recommendation to heart to be stricter in considering if a grant support really is the best instrument.

Governance and institutional maturity of MFIs

It is clear that the supported MFIs - in spite of the growth in outreach - are often still fragile in efficiency, risk management, governance provisions and management information systems. We should increase our attention for these aspects in the assessment, monitoring and support of these organisations. To gain more insight in the contribution of the CFAs to the process of maturation of the MFIs we need to develop a more sophisticated method to keep track of developments in governance issues. This is currently being taken up by the CFAs in MicroNed (development of the so-called Microscore tool).

Concentration of interventions

The evaluators warn that the additionality[3] of the support of the CFAs may be restricted as a result of the concentration on a limited number of countries and overlap in portfolios. They find no significant difference between the portfolios of the CFAs in terms of type of organisation supported or the location

[3] By additionality it is meant that funding by public (or donor) money should not crowd out funding by commercial and private funders, as the objective is that donor money is facilitating the growth of organizations in order to qualify for commercial sources of financing. In the study also reference is made to the additionality of the CFAs with respect to eachother: we should not fund the same organizations and be active in the same regions, or even sectors, in one country.

(urban, rural) of their partners. Only ICCO has chosen to focus its microfinance activities explicitly on rural and remote areas. The other CFAs also emphasise the rural sectors, but they do not exclude urban MFIs. The CFAs are active in a large number of countries (72), however 43% of the combined number of interventions take place in nine countries.

According to the CFAs this concentration is partly the result of the dynamics of the MFI sector in these countries. In some countries like India there is a huge demand for microfinance. In other, very poor countries like Somalia and Sudan the conditions for supporting microfinance are not sufficiently developed, therefore we are less active in the field of microfinance in those countries.

MicroNed has been established by the CFAs exactly to better coordinate their grant funding activities and to avoid duplication. It has adopted a Code of Conduct, which sets rules in cases where more than one CFA wish to work with one MFI. Only in exceptional circumstances, CFAs will grant- support the same micro finance institutions. When this is the case, the lead agency principle is applied. Loan funding is a different case, the CFAs are of the opinion that it even might be necessary to share risks with others when financing large clients, and therefore the support of different CFAs to one MFI can be justified.

Improvement of administrative systems

The evaluators found that the grant operations and other operations managed by the CFAs themselves are not supported by proper administrative systems. It took the evaluators considerable time and efforts to gather the correct financial data from the CFAs on their microfinance commitments and disbursements. Often data provided in the overall information sheet was not compatible with figures in grant agreements and other data. This is an important point of concern for the CFAs. In the years following the period under study, the four CFAs have started to make necessary improvements in their administrative systems and to develop new MIS and databases. Moreover, CFAs have agreed to provide all microfinance data to be installed in a database of the Netherlands Microfinance Platform that will also be used for MicroNed and CGAP.

4. Joint follow-up actions

In June 2010 a meeting will be organized with the CFAs, MicroNed and other stakeholders. In this meeting the findings and recommendations will be presented.

Apart from this, some joint actions have already been taken up within MicroNed (already mentioned in point 3), such as:

- Increased attention for Social Performance Management, including gender and client protection principles.
- Improved monitoring of capacity building of MFIs, including governance, by developing and implementing a new tool, the Microscore Tool.
- More attention for harmonization and complementarity by country focus groups and thematic groups, especially in the areas of rural finance, SPM and capacity building.