

**REVIEW OF UNDP
MICROFINANCE PORTFOLIO**

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Executive summary

In October of 2002, UNDP participated in a “Peer Review” of its microfinance operations, inviting microfinance specialists from other agencies to comment on the strengths and weaknesses of UNDP policy, systems, and staff in relation to effective support for microfinance (“microfinance” refers to financial services—mainly credit at present—for poor people). Following that review, in 2003 the Administrator requested CGAP¹ to do a more intensive project-by-project evaluation of the quality of all of UNDP’s on-the-ground microfinance operations, including active projects and those closed in 2001 or 2002.

How was project quality evaluated? The author, a microfinance specialist on CGAP’s core staff, graded 66 projects using a five-point scale. Most of these were microcredit projects, providing tiny loans for poor clients. For projects where a formal, professional microfinance institution (MFI) managed the loans, the most important determinant of the grade was whether the project resulted in, or appeared likely to result in, “sustainable” credit delivery. Sustainability means that the MFI collects its loans *and* covers all its costs well enough so that the lending operation can continue serving its poor clients, and reaching out to increasing numbers of them, even after it is no longer getting grants or soft loans from donors or government. Some of UNDP’s projects are community-managed revolving loan funds, where there is no professional management of the lending and collection. The test applied to such revolving loan funds was less stringent: they were judged according to how well participants repaid the loans (in other words, would the revolving fund actually revolve for very long, or would money intended for the whole group be rapidly siphoned off by a minority of defaulters?). Projects meeting those standards were rated 3 or 4.

For simplicity of presentation, grades in this report have been collapsed into three categories: Good (3 or 4), Weak but minimally acceptable (2), and Unacceptable (0 and 1).

How well is UNDP supporting microfinance? The average grade for all UNDP’s projects is on the lower end of “Weak.” Out of 66 graded projects, only 14 projects (21 percent) were rated “Good,” and 28 projects (42 percent) were judged “Unacceptable.” This unhappy picture places UNDP toward the lower end of the spectrum of donor agency effectiveness in microfinance—a finding that is consistent with the results of the peer review process.

No trend of improvement is visible: recent projects did not score materially better than older projects.

¹ The Consultative Group to Assist the Poor (CGAP) is a consortium of most of the public international donor agencies that support microfinance. Along with UNDP, most of CGAP’s other members asked for a Peer Review.

But in the midst of a disappointing general picture, closer analysis shows that UNDP has already developed—and tested widely—one microfinance support model that produces good results. For this reason, the ultimate message of this evaluation is an optimistic one: UNDP can make major improvements in the effectiveness of its microfinance work by the “simple” expedient of implementing its successful model more widely, and abandoning other approaches that have failed.

The successful model is the MicroStart programme pioneered by the microfinance unit of the United Nations Capital Development Fund (UNCDF Microfinance). The key elements of the MicroStart approach have been that project implementation is done, or very closely guided by, a technical service provider from a pre-qualified list of providers that have already demonstrated their ability to produce sustainable microfinance; there is regular reporting to a centrally-reviewed database, including such key indicators as number of clients, average loan size (a very rough proxy for client poverty), repayment, and cost recovery; MFI that do not meet performance standards are dropped from the programme, unless the technical service provider is confident that MFI managers will correct the problems; and UNCDF Microfinance collaborates closely with the country office in design, implementation, and monitoring of the project.

MicroStart projects, and more generally projects where UNCDF Microfinance staff participated substantially, scored much better other projects. The average grade of MicroStart projects was 2.58 (on the lower end of “Good”) as compared to 1.44 for the rest of the portfolio. MicroStart’s “hit rate” of successful projects was 69 percent, which represents strong performance, not only compared to other donors, but also in absolute terms. Microfinance is a risky and demanding business, where even the most skilled donor imaginable cannot expect consistent success.

Microfinance-only projects performed better than microfinance components in larger projects, presumably because the microfinance was likely to get more concentrated management attention in stand-alone projects. Not a single component got a Good rating.

Performance of community-managed revolving loan funds was so consistently bad that this model never represents a sensible gamble.

Projects where government is not actively involved were likely to perform considerably better. UNDP’s close working relationship with host-country government turns out to be a comparative disadvantage when supporting microcredit.

UNDP’s strongest comparative advantage for doing microfinance appears to be the technical staff of UNCDF Microfinance and the MicroStart model.

Principal recommendations. The root problem with UNDP microfinance is not staff incompetence or lack of commitment to doing good work for poor people. On the contrary, the evaluation shows a picture of good people facing incentive, information, and resource problems, most of which can be ameliorated.

- Announce and implement a policy that UNDP will use the MicroStart model (or a restructured equivalent) whenever it funds, or administers others' funding for, microcredit operations.
- Maintain the technical expertise that UNCDF Microfinance has built up, and insure that any re-organization of UNCDF preserves this unit and keeps its principal focus on support for UNDP operations.
- Prohibit community-managed revolving loan fund projects.
- Provide substantive training opportunities for staff that are responsible for managing microfinance programmes.
- Consider the possibility of creating a UNCDF Microfinance-managed funds that supports selected country office projects.

After delivering the original version of this report, the author has learned that UNCDF may be restructured in such a way that its services will no longer be available to a substantial portion of UNDP country offices. If this happens, then it is strongly recommended that UNDP set up an equivalent to the MicroStart programme, including the expert staff to administer it, within UNDP.

Without administration by an expert core staff, a recommendation to apply the "principles" of MicroStart is likely to fall well short of the intended effect.

The vast majority of projects reviewed were microcredit projects where UNDP directly or indirectly funded loan delivery. However, at present donor activity in microfinance is broadening out into other areas, including (1) non-credit services like savings, insurance, and money transfers structured to meet poor clients' particular needs; (2) work on the legal and policy framework in which microfinance institutions operate; and (3) building local microfinance support services like training, technical consultants, and auditors. This evaluation could not develop evidence about these other approaches. But it is important that the evaluation's near-exclusive focus on microcredit not be taken to imply a judgment that other avenues of microfinance support are unimportant or unpromising.

Introduction

Along with most of the other donor members of CGAP, UNDP asked in 2002 for a “peer review” of its microfinance operations.² In October of that year, representatives of the Asian Development Bank, the German development agency KfW, and CGAP joined with UNDP/UNCDF staff in an intensive five-day diagnostic exercise. The peer review report (Attachment 1) assessed UNDP’s strengths and weaknesses in supporting microfinance, and recommended among other things that UNDP conduct a project-by-project evaluation of its whole microfinance portfolio. In a spirit of transparency, UNDP Administrator Mark Malloch Brown asked an outside agency—CGAP—to lead this evaluation.³

The Administrator’s request was highly unusual: development agencies are very seldom willing to submit their operations to a detailed review by another development agency. Furthermore, UNDP agreed in advance that CGAP would be free to publish the findings—even though there was little doubt that the evaluation would document some significant problems. The Administrator’s action demonstrated real seriousness about going beyond business as usual in order to make UNDP’s microfinance operations substantially better. UNDP has positioned itself as a leader among CGAP’s member donors in carrying forward our mutual commitment to improved aid effectiveness.

The purpose of this review is to examine the performance of UNDP projects in microfinance, comparing UNDP’s practices with generally accepted best practices, and to recommend practical ways the agency can improve the overall effectiveness of UNDP microfinance programmes. Consistent with UNDP’s corporate objectives, improved performance should increase the capacity of UNDP-supported institutions and programmes to leverage not only additional donor funding, but more importantly private sector resources. When microfinance is done right, it mobilizes significant private sector resources to support the achievement of the Millennium Development Goals.⁴ In addition to improving the overall quality of the portfolio, this review is meant to serve key corporate priorities in the areas of knowledge and results based management.

² The Consultative Group to Assist the Poor (CGAP) is a consortium of most of the public international donor agencies that support microfinance.

³ UNCDF staff, especially Kiendel Burrit and Marc Jacquand, made major contributions to the evaluation. However, CGAP assumed responsibility for its design and management, avoidance of intra-agency bias, the interpretation of its results, and the choice of recommendations. We are prepared to vouch for the independence and objectivity of the evaluation. If there are flaws in its design and execution, we alone are responsible.

⁴ For a summary of evidence about whether microfinance contributes to the Millennium Development Goals, see Littlefield, Morduch, and Hashemi, *Is Microfinance an Effective Strategy to Reach the Millennium Development Goals?* CGAP Focus Note No. 24, January 2003 (http://www.cgap.org/docs/FocusNote_24.pdf).

I. Scope and Methodology

Identifying projects and collecting basic information

UNDP's project operations—especially smaller projects—are highly decentralized. Thus, headquarters has no database identifying all the microfinance projects in the Country Offices. In September of 2003, all Country Offices received a questionnaire (Attachment 2) asking for basic information on their microfinance projects, including projects that were currently active and those that had been closed in 2001 or 2002. “Microfinance” was defined as follows:

Microfinance refers to financial services for poor and vulnerable populations, including credit, savings, insurance, and money transfers. For the purposes of this Review, microcredit refers to loans of money or goods that are supposed to be paid back (with or without interest) to a revolving fund, social fund, bank, microfinance institution, NGO, project implementation unit, etc. Please consider any loans smaller than \$2,000 to be microcredit loans. If you are not sure whether a project fits the definition of microfinance, please include it.

Information requests from headquarters can be a significant burden for Country Offices. We kept the questionnaires as simple as possible, and told respondents that they need not spend more than three hours filling out information for any project. We did this not only out of respect for Programme Manager's time, but also in order to encourage response. Probably as a result of the Administrator's personal endorsement of the exercise (cf. Attachment 3), the response rate turned out to be better than we had expected: responses from 112 country offices provided information on 86 projects. There is no way to be sure how many projects were not reported, but knowledgeable staff thought that the exercise captured a very high percentage of UNDP's microfinance operations.

We told Country Offices that the purpose of the evaluation was to get a general picture of UNDP's overall microfinance portfolio, rather than to give a report card and recommendations for each individual project. We promised not to disclose our ratings of individual projects except at the request of the country office. After much discussion, we concluded that this less-than-fully-transparent policy would improve the accuracy of the evaluation by making it easier for Country Offices to share information about problems with us.

Field visits

Highly respected microfinance experts conducted on-site assessments of 7 projects (cf. terms of reference in Attachment 4). As described in the next section of this report, CGAP developed quality grades for 66 projects. First, “desk review” grades were assigned, excluding any information from the on-site field visits. When the on-site results were later factored in, they did not produce substantial changes in the desk-review grades that had been developed from the other information that had been collected. This result increased our confidence in the desk-review grading process, and also led us to cancel a few additional field visits that were in the pipeline.

Grading the projects

Of the 86 projects reported, CGAP graded the quality of 66 projects.⁵ The grading protocol (Attachment 5) included objective indicators but also called for judgments based on professional experience. Projects were scored as follows:

- 4 Exceptionally effective. A star project that deserves to be publicized as an example of getting things really right.
- 3 Good. Worth extending or replicating, if the opportunity arose.
- 2 Weak but minimally “acceptable”. The rater wouldn’t support such a project, but wouldn’t veto it either if a Country Office really wanted to do it.
- 1 Unacceptable. Unlikely to produce a decent development return on the funds invested. The rater would veto such a project.
- 0 Exceptionally bad. Probably does serious damage, or represents extreme bad practice.

Attachment 5 contains details of the grading protocol. Differing criteria were applied to two major groups of projects: formal microfinance institutions and revolving fund projects.

Formal microfinance institutions (MFIs) have professional staff who are intimately involved in the approval and collection of retail loans. An MFI project got a rating of “Good” or better only if it resulted in an institution that collects its loans and covers its costs well enough to be sustainable over the long term—or at least appears likely to have such a result within a reasonable period after inception (5 years, up to 10 years in exceptionally tough cases).

Revolving Fund projects set up community-managed revolving loan funds (CMRLFs) with substantial infusions of external capital. Approval and collection of loans is handled by the members rather than by professional staff. To get a rating of “Good” or better, a revolving fund project only had to show loan collection that was good enough so that the fund actually continued revolving for five or more years at least. Otherwise resources intended for the whole community are quickly siphoned off by a minority of defaulters.

⁵ Projects were not graded if (1) the focus of the project was Business Development Assistance with only a link to other microfinance programmes, (2) the size of the project was too small (<\$25,000); or (3) there was insufficient information to allow even a guesstimate of project quality.

Thus, ratings were heavily based on collection and cost coverage, for reasons that will be discussed in the next section. In projects where there was no direct performance information, the project grade reflected compliance with generally accepted principles of good practice.⁶ “Good practice” refers to strategies that have been shown to produce sustainable outcomes in the past.

Projects differed in the amount and quality of information available. So for each project grade, a confidence level was assigned answering the question “how confident is the grader that the grade derived from present information is the same grade that would be assigned if full information were available?” This enabled those projects with better information to carry more weight than those whose grades appeared more tenuous.

No. of Projects	Confidence Level
17	High: very confident in the grade assigned
24	Medium: available information yielded substantial indications
25	Low: the minimal information available supports a guess, subject to a high possibility of error

Information on a few projects was so sparse that no grading at all was possible; these have been excluded from the presentation.

While grades for some individual projects were subject to considerable margin for error, the review produced enough information to create a meaningful picture of the overall UNDP microfinance portfolio. (When project grades were weighted by confidence level—so that the less reliable grades had less impact—the weighted average score was 1.79, which is very close to the unweighted average of 1.77.)⁷

Repayment and cost coverage as quality criteria

The key criteria used to evaluate projects were repayment and the potential for cost coverage.

Almost all of UNDP’s microfinance projects focus on credit delivery. Credit projects of all sorts have been the subject of controversy in donor agencies for decades. Some people do not agree that self-sustaining loan collection and cost recovery should be essential criteria in judging credit projects. This report is not the place for an extended

⁶ Of the 66 graded projects, three were policy-only projects, involving no direct support to MFIs. These were graded on the likelihood of a meaningful and useful policy outcome. These grades involved more speculation—and therefore less confidence in the grade—than grading of the MFI and revolving fund projects.

⁷ This report is based on the author’s own grading of projects. However, as an ex-post check on consistency, two other microfinance experts were asked to grade the projects, using the same grading protocol. The grading proved very consistent. In most of the cases, the other two experts came up with the same grade as the author. Where discrepancies occurred, they were single-grade discrepancies (for instance, the author and one of the other experts graded a project as “2” while the other expert graded it as “1”). Many of these discrepancies occurred when all three experts thought that a project fell in between two rungs on the grading ladder. Since pluses and minuses were not recorded, two of the experts might settle on the higher grade while the third settled on the lower, or vice versa.

discussion of the issues involved, but readers are entitled to a concise statement of the main reasons for giving those criteria heavy weight in this evaluation.

Loan collection and financial sustainability are certainly not ends in themselves. They are relevant only to the extent they contribute to the welfare of the poor and near-poor clients served by microfinance. It is notoriously difficult and expensive to quantify household benefits resulting from financial services and to demonstrate causality, so it is not practical for most projects to produce such impact studies. At the same time, a good number of solid, reliable impact studies have been conducted on all sorts of microfinance clients in every region of the world. The pattern of results from these studies supports the proposition that access to credit can contribute to achieving the MDGs, by lowering poor households' vulnerability to shocks, and improving income, assets, health, education, and housing of clients (cf. footnote 4).

Given those benefits, it would be hard to justify a categorical rejection of the possibility of subsidizing non-self-sustaining microfinance. Rather, the argument for sustainability rests on pragmatic circumstances, not ideological principles about subsidization or financial systems. The analysis must begin with recognition of two practical facts:

- Credit access is not a one-time need for poor households. It should be a continuously available resource. Impact studies tend to find that clients reap the most significant benefits after multiple loan cycles.⁸
- There are hundreds of millions of poor households who lack access to good financial services. Subsidized funds from donors and governments are severely limited, and could never cover more than a small fraction of that demand. To deliver anything like their full potential, microfinance providers need to be stable, and eventually to expand their outreach beyond the narrow limits of what can be funded with subsidies. Hundreds of experiences all around the world demonstrate that both of these are eminently possible when microfinance is done right, even when clients are very poor.

It is obvious how cost-recovery bears on stability: if the interest income that a microfinance institution (MFI) receives from its customers continues to be less than its operating costs, the resulting losses will eat away whatever subsidized capital the MFI has been given. Slightly less obvious is the relation between loan collection and stability. Most microcredit is uncollateralized. The borrower's principal motivation to repay the loan is a desire to keep access to the highly valued loan service in the future. We find again and again that this motivation unravels quickly if repayment is not kept at very high levels. When a client sees neighbors failing to pay, her confidence in the lender's future

⁸ For instance, Zaman, Hassan. "Assessing the Poverty and Vulnerability Impact of Micro-Credit in Bangladesh: A Case Study of BRAC". Commissioned by CGAP for the WDR 2000/01; Chen, Marty and Donald Snodgrass. "Managing Resources, Activities, and Risk in Urban India: The impact of SEWA Bank., 2001"; Dunn, Elizabeth and J. Gordon Arbuckle. "The Impacts of Microfinance: A Case Study from Peru", Office of Microenterprise Development, USAID.

viability falls, along with her incentive to repay her own loan. It turns out that if more than about 10 percent of an MFI's loans are not being paid on time, or if it loses more than about 5 percent of its loan capital to default in a year, the situation can seldom be managed stably: if the MFI does not fix the problem quickly, it is likely to spin completely out of control. Most MFI failures result from repayment problems.⁹

But stability is not enough, at least if we think beyond the MFI's present clients and consider the much larger number of potential clients who do not yet have access to good financial services. After a few years, when an MFI reaches the point of covering all its costs from interest income (i.e., the point of profitability), it can begin to fund its expansion by tapping large pools of money that were not previously available to it. It can get loans from commercial banks. Much more powerfully, it can eventually operate with a license from government financial authorities that allows it to collect deposits, which can multiply its lending capital by five to ten times.¹⁰ These are not pipe dreams: increasing numbers of MFIs in every region of the world are achieving such results.

As noted above, reliable studies of the impact of microfinance are challenging and costly. But an MFI's ability to operate sustainably conveys some important information about impact. If the clients are willing to pay enough interest to cover all the costs of their loans, and repeatedly repay those loans in order to keep access to the service, then they are "voting with their feet,"—i.e., demonstrating that they judge the benefits of the loans to be greater than the costs. Their behavior doesn't tell us much about the *quantity* of net benefit they receive, but it does prove that they see the cost-benefit relationship as a positive one.

One of the strongest reasons to insist on sustainable repayment and cost recovery is simply that we know that they are possible in well-run programmes, even those that serve poorer clients. Tens of millions of very poor people are being served by sustainable MFIs.¹¹ In a setting where cost recovery is really impossible, the benefits of microfinance might conceivably justify a continuing subsidy. But cost recovery is

⁹ Loan collection reports require careful interpretation. For instance, it is tempting, but completely mistaken, to assume that a 95% "repayment rate" (i.e., amounts paid as a percentage of amounts due) is equivalent to losing 5% of one's loan portfolio per year—and thus represents acceptable collection performance. Actually, in an MFI whose loans are repaid in 13 weekly installments, a 95% repayment rate would wipe out 37% of its loan fund in one year. For an explanation of this surprising result, and more discussion of collection measurement, see "Measuring Microcredit Delinquency," CGAP Occasional Paper No. 3, 1999 (http://www.cgap.org/docs/OccasionalPaper_03.pdf).

¹⁰ Deposits are more than a funding source for the loan portfolio; they can also be a very valuable service to the MFI's base of poor clients. MFIs that offer both loans and good voluntary deposit services typically find themselves with five savings customers for every loan customer. The notion that savings accounts are unimportant for the poor because the poor don't have money to save sounds like plausible common sense, but it turns out to be untrue.

¹¹ Microcredit cannot reach all the poor. There is probably some lower boundary below which credit interventions are neither sustainable nor appropriate. It is no service to indebt people who are so poor that they do not have realistic business/investment opportunities or any likely income source that is reliable enough so that they can repay the loan. Arguably, those extremely destitute people are the ones that donor agencies ought to care most about reaching, but credit is far less effective than other interventions (e.g., health, education, or rural infrastructure) in meeting their needs.

usually quite possible: the failure to achieve it is typically a function of the MFI's vision or competence, not the client group being served.

Finally, it is worth noting that the emphasis on loan collection and cost recovery is not just an idiosyncratic opinion of one evaluator. Consortia of the world's microfinance donors have continually endorsed this approach. Even before the formation of CGAP, the Committee of Donors for Small Enterprise Development adopted and published consensus guidelines on microfinance (the "pink book") which recognized that "funding based on large, ongoing subsidies with a charity rationale has failed," and called for donors to insist on solid loan collection and eventual financial sustainability in the MFIs they support.¹² Over the ensuing years, the member agencies of CGAP have endorsed a series of consensus guidelines, all of which incorporate or presuppose the same position: sustainability is not the purpose of microfinance, but it is an essential prerequisite to attaining that purpose in a massive way.¹³

II. Principal Findings of the Study

In presenting results, this section will use average grades as well as tabular presentation of data. Average grades are based on the rating scale discussed above (4 = Exceptionally strong, 3 = Good, 2 = Weak but minimally "acceptable", 1 = Unacceptable, 0 = Exceptionally bad). In order to simplify tabular presentation, project grades have been grouped into three categories:

- Good (grades 4 and 3)
- Weak (grade 2)
- Unacceptable (grades 1 and 0).

Overall quality of UNDP microfinance portfolio

The average grade for all UNDP's projects is on the lower end of "Weak." Out of 66 graded projects, only 14 projects (21 percent) were rated "Good," and 28 projects (42 percent) were judged "Unacceptable." This unhappy picture places UNDP toward the lower end of the spectrum of donor effectiveness in microfinance—a finding that is consistent with the results of the peer review process.

¹² "Small and Microenterprise Finance: Guiding Principles for Selecting and Supporting Intermediaries" (1995), available at http://www.undp.org/sum/sum_reports/donor_guidelines.html.

¹³ See http://www.cgap.org/policy/consensus_guidelines.html.

Table 1
Portfolio Grade

Project Rating	Number of Projects	Percentage of Portfolio
Strong (Grade \geq 2.67)	14	21.2%
Weak	24	36.4%
Unacceptable (Grade \leq 1.33)	28	42.4%
Total	66	100%
Portfolio Weighted Average Grade	1.79	

Is quality getting better?

No pattern of improvement over time can be discerned:

Table 2
Average grade per start year

Start Year	Average weighted grade	Number of projects
<1998	1.70	6
1998	2.62	9
1999	2.10	13
2000	0.88	5
2001	1.50	7
2002	1.63	5
2003	1.94	13
N/A*	1.37	8

* 8 projects did not report the start year

Two portfolios!

In the midst of a disappointing general picture, closer analysis shows that UNDP has already developed—and tested widely—one microfinance support model that produces good results. For this reason, the ultimate message of this evaluation is an optimistic one: UNDP can make major improvements in the effectiveness of its microfinance work by the “simple” expedient of implementing its successful model more widely, and abandoning other approaches that have failed.

The evaluation surprised everyone by revealing a striking division. One class of projects (“TSP” projects) involved some technical service provider who had a strong recognized track record of delivering sustainable microfinance. The other class of projects, which we labeled “non-TSP,” did not. The average grade of TSP projects was **2.41**, as against **1.30** for non-TSP projects. Only one non-TSP project achieved a Good rating. Most of the non-TSP projects were graded Unacceptable.

The majority of the TSP projects were done under the MicroStart programme developed by UNCDF’s Microfinance Unit and/or drew on UNCDF technical help from the beginning of project design. The UNCDF Microfinance Unit, formerly the Special Unit for Microfinance (SUM), has provided technical support to UNDP microfinance since 1997. In 2002 the Administrator named UNCDF as the policy advisory and technical assistance centre for microfinance in UNDP through a Memorandum of Understanding with BDP. Under this agreement, UNCDF provides policy guidance for UNDP support to microfinance, provides technical advisory services to UNDP on a fee-for-service basis, moderates the global knowledge network SURF-SEMFAN, and provides microfinance training to UNDP staff members through seminars and workshops.

The key elements of UNCDF’s MicroStart approach are that project implementation is done, or very closely guided by, a technical service provider from a pre-qualified list of providers that have already demonstrated their ability to produce sustainable microfinance; there is regular reporting, including such key indicators as number of clients, average loan size (a very rough proxy for client poverty), repayment, and cost recovery; MFI’s that do not meet performance standards are dropped from the programme, unless the technical service provider is confident that MFI managers will correct the problems; and UNCDF Microfinance collaborates closely with the country office in design, implementation, and monitoring of the project.

Table 3
TSP vs. Non-TSP Project Performance

	<u>Non-TSP projects</u> n = 41	<u>TSP Projects</u> n = 25		
		<u>TSP-- MicroStart</u> n = 16	<u>TSP-- non-MicroStart</u> n = 9	<u>Total TSP</u> n = 25
Good	1 (2%)	11 (69%)	2 (22%)	13 (52%)
Weak	17 (42%)	2 (12%)	5 (56%)	7 (28%)
Unacceptable	23 (56%)	3 (19%)	2 (22%)	5 (20%)
Weighted Avg. Grade	1.30	2.58	2.03	2.41

The technical service provider’s recognized track record of producing sustainable microfinance turns out to be very important. Projects that had technical service providers without such a track record scored no better on average than projects that had no technical service provider at all.

The conclusion about the traditional, non-TSP portfolio is clear. If this kind of project were the best UNDP could do, the agency’s wisest course would be simply to leave microfinance to others.

The TSP portfolio is much better. But is it good? Does a 52 percent “hit rate” of good results represent donor effectiveness? Based on our experience looking at donor

microfinance work over two decades, we would probably answer “yes.” Building microfinance in new markets is hard, and it is risky. Microfinance support is like venture capital: even the smartest donor can’t pick winners consistently. But the winners produce such good results that they compensate for the costs of some reasonable number of failed or mediocre investments. Even if one weren’t satisfied with the success rate of the TSP model, it has performed so much better than the rest of UNDP’s microfinance projects that it ought to become the agency’s standard approach to supporting microfinance retailers.

But closer analysis suggests that the strongest predictor of success is not just the presence of a TSP with a track record, but rather the project’s participation in the MicroStart programme, which entails not only a TSP with a track record but also close collaboration with UNCDF Microfinance and rigorous reporting of results to a central database. The table above shows that of the 25 TSP projects, 16 were MicroStart projects and 9 did not use MicroStart. The average grade of the non-MicroStart TSP projects was 2.02, which is moderately better than the grade of the non-TSP projects; however, only two out of the 9 non-MicroStart Projects received a Good grade.

Among the 16 MicroStart projects, 11 were rated Good, for a highly satisfactory “hit rate” of 69%. The average grade of the MicroStart projects was **2.58** (on the lower end of Good), compared to **1.44** for all the rest of the UNDP portfolio.

Establishing MicroStart took a great deal of time and work, not least of all because it involved a significant departure from normal UNDP procurement patterns. In its early years, the programme drew criticism from quite a few outside stakeholders, mainly because of implementation and disbursement delays. Having heard some of that criticism, the author of this report anticipated low MicroStart quality and was quite surprised to find that actual outcomes have been so strong. But the results of this study speak for themselves, and underscore the contribution of Henry Jackelen, John Tucker, and their colleagues¹⁴—the people who designed MicroStart, won approval for it, and made it work. Without MicroStart, the UNDP microfinance portfolio would look dismal indeed.

UNCDF Microfinance involvement

UNCDF Microfinance is the unit that manages UNCDF’s own microfinance portfolio but also provides technical support to some UNDP country offices during design and implementation. In terms of technical competence, UNCDF Microfinance is recognized as one of the strongest central microfinance units among CGAP’s 28 member agencies.

¹⁴ Koen Toonen, Maigee Chang, Casper Sonesson, Mila Co, Paula Drakes, Jim Provenzano, Richard Kerby, Feisal Hussein, Anne Marie Chidzero, Pancho Otero, Maria Paula Carvajal, Kristin Bogart, Shaheen Mohamed, Juan Mendoza, Yuri Afanasiev, Jerzy Szeremeta, Ali Al-Za’Tari, Margaret Chi, Susan Gibson, Deena Burjorjee, Ian Beattie, Belinda Gutierrez, Kiendel Burritt, Cecilia Dugos, Rajesh Shrestha, Annette Krauss, Jo Woodfin, Concepcion Cole, Heather Clark, Marc Jacquand, and Peter Kooi all contributed to the global MicroStart Programme.

As discussed above, UNCDF Microfinance is heavily involved in MicroStart projects, but also supports other UNDP projects. The study found a robust correlation between heavy UNCDF Microfinance involvement and project effectiveness. The average grade of projects with heavy UNCDF Microfinance involvement was 2.33, compared to 1.44 for projects with less or no UNCDF Microfinance participation. However, non-TSP projects produced poor results regardless of input from UNCDF Microfinance.

Table 4
Project Performance and UNCDF involvement

	UNCDF Involvement	Number of Projects	Weighted Avg. Grade	Good	Weak	UA
Total UNDP Portfolio	<i>Heavy</i>	21	2.33	11	5	5
	<i>Medium</i>	7	1.43	0	3	4
	<i>Low (=none)</i>	38	1.45	3	16	19
		66	1.79	14	24	28
Non-TSP Projects	<i>Heavy</i>	2	1.25	0	1	1
	<i>Medium</i>	5	1.44	0	2	3
	<i>Low (=none)</i>	34	1.28	1	14	19
		41	1.30	1	17	23
TSP Projects	<i>Heavy</i>	19	2.43	11	4	4
	<i>Medium</i>	2	1.40	0	1	1
	<i>Low (=none)</i>	4	2.78	2	2	0
		25	2.41	13	7	5

Reporting of project performance

The questionnaire asked for key performance indicators—mainly number/volume of active loans, collection performance, and cost recovery—for each project. The average grade of projects with good reporting was 2.20, as against 1.49 for projects with bad reporting. This squares with years of microfinance experience around the world: projects that report well on key performance indicators are much more likely to be effective.¹⁵

¹⁵ Trying to correlate reporting with the raters' quality grades involves a degree of circularity. In some of the projects, poor reporting was a factor that entered into the grade. To that extent, the apparent correlation between reporting and quality could be just an artifact of the grading protocol. However, the importance of strong information systems and reporting is a widely recognized canon of good practice in microfinance. CGAP evaluated the World Bank's microcredit lines at the same time as it was evaluating UNDP's microfinance projects. In the World Bank study, quality of reporting was carefully excluded from the grading criteria, but the result was the same: projects with weak reporting were less effective.

Of the 17 projects whose reporting was rated “High,” 9 were MicroStart projects.

Table 5
Reporting Quality and Project Performance

Quality of Performance / Reporting	Weighted Avg. Grade	Total	Good	Weak	UA
High (reasonably filled out indicators)	2.20	17 100.0%	7 41%	4 24%	6 35%
Med (filled out half of the indicators or reported numbers seem unreasonable on their face)	1.67	17 100.0%	3 18%	7 41%	7 41%
Low (performance indicators not filled out or unintelligible)	1.36	23 100.0%	3 13%	6 26%	14 61%
NA*	2.14	9 100.0%	1 11%	7 78%	1 11%
Total	1.79	66	14	24	28

* Reporting could not be rated for policy projects or pipeline/new projects.

Government involvement

UNDP works more closely with host governments than do some other development agencies. Of the 66 graded projects, 25 had substantial government involvement in their design and implementation, including direct delivery of the microcredit in one case.

Development agencies generally regard active government participation in, and “ownership” of, our projects as a good thing. Unfortunately, microcredit is different. When government involvement in microcredit—indeed, in credit of any kind—goes much beyond providing security, macroeconomic stability, and a suitable legal framework, the results tend to be bad. There have certainly been some important counter-examples, but decades of experience in development finance confirm the general pattern. Governments have strong incentives to have credit programmes disburse large amounts of money quickly to win political favor, even though sound microfinance institutions are built on prudent disbursement of loans: borrowers need to be screened, and loan activity shouldn’t outpace the development of operating systems to manage that activity. In the same vein, MFIs need higher-than-normal interest rates in order to cover the costs of administering thousands of tiny loans, and they need to maintain stringent loan collection if they are to survive, but neither of these things are politically popular.¹⁶

¹⁶ The conflict between government incentives and good credit practice does not necessarily apply in the case of other financial services, such as loans or insurance. For instance, government savings banks may

Hence, credit programmes where government is significantly involved in design (interest rates, loans sizes) or implementation (disbursement and collection) tend to perform poorly.

The results of this evaluation correspond to the general pattern of experience with government involvement in credit. Of the 14 projects with Good results, 13 did not involve government in the design and implementation of programmes. In the MicroStart model, an advisory investment committee is formed that vets proposed investments and monitors the performance of Technical Service Providers and institutions supported by MicroStart against performance-based contracts. This Committee is comprised of individuals from the private sector, including banks and non-profits, as well as donors, and individuals from relevant government bodies. The Committee provides a forum for educating government and other members about microfinance and constitutes positive, but relatively low levels of engagement of government in direct project administration. Investment Committee members are not involved in the direct operations of MFIs.

[In 2003, UNCDF moved toward a “sector development approach” for its own new investments in microfinance. UNDP Country Offices are engaged in sector programmes through co-investments with UNCDF. The sector approach incorporates elements of MicroStart with respect to developing the capacity of retail MFIs. But it has a broader scope, including policy development and work with industry support institutions such as training companies or audit firms. Sector development programmes seek to develop a shared vision among stakeholders including a national microfinance policy, strategy and action plan. Sector programmes include support for the development of Central Bank microfinance units to work on the legal and regulatory framework. (Obviously, government involvement is essential when it comes to issues of policy and financial regulation.) Given that this approach has only been very recently applied in UNDP, there is little evidence yet that speaks to its relative success or failure, and this evaluation developed no conclusions with respect to it.]

Revolving Loan Funds

Of the 66 graded projects, 14 involved community-managed revolving loan funds (CMRLFs). In general, these projects

- Identify or organize community groups that are to lend to their members,
- Inject external grant or loan capital to fund the lending, and
- Leave credit decisions and collection in the hands of the group members, rather than professional staff.¹⁷

be subject to the same problems that beset all public bureaucracies, but they frequently do a respectable job of providing deposit services, including deposit services for poor people. The political implications of savings are much lower, and it is unaffected by the perverse incentives that surround credit.

¹⁷ The community-managed revolving loan fund category does not include most “village banking” programmes. In the prevalent village banking models, a professional microfinance institution exercises close supervision over the operations of every group. An MFI loan officer is typically present at all group meetings.

In the grading process, a less rigorous standard was set for revolving fund projects than for projects involving a professional MFI. Nevertheless, not a single revolving fund project could be rated Good. Over two-thirds of these projects were rated Unacceptable.

The common problem with such revolving funds is that they don't revolve for very long: the fund is siphoned off into the hands of members who default on their loans, leaving the rest of the members without the continuing credit access the project was supposed to give them.

Table 6
Revolving Fund and Project Performance

Project Type	Weighted Avg. Grade	Total	Good	Weak	UA
Revolving Fund	1.37	14	0	4	10
Non-Revolving Fund	1.87	52	14	20	18
Total	1.79	66	14	24	28

These results are consistent with a recent CGAP review of dozens of revolving fund evaluations from a range of agencies. CMRLFs where the lending is funded by large early injections of external capital (i.e., the kind of revolving fund encountered in the UNDP portfolio) practically never work well. The few successes were virtually all in projects where the community groups are savings-based, and where external capital is never injected, or injected in moderate amounts late in the process. Such projects tend to be less attractive to donors because they don't provide a vehicle for disbursing large amounts of funds.

Difficult environments

Twenty of the projects were attempting to do microfinance in circumstances where microfinance is particularly difficult, mainly (1) conflict and post-conflict situations affected by weak public security, client instability, or restricted economic opportunities; and (2) very remote or sparsely populated rural areas, where the cost of service delivery becomes much higher. We were able to give a Good rating to only one of these projects, and half of them were graded Unacceptable.

Table 7
Environment and Project Performance

	# of projects	Weighted Average Grade	Good	Weak	UA
Difficult circumstances	20	1.26	1	8	11
Normal circumstances	46	2.01	13	16	17

Since 2003, UNCDF has begun to partner with Country Offices in the funding and/or implementation of programmes in post-conflict countries (Sierra Leone, Liberia, Angola, and Congo). It is possible to do sound microfinance in post-conflict environments where some minimum criteria exist: low intensity of conflict, reasonable safety for the clients and microfinance providers, and some stability of movement among returnees and refugees. Beyond minimum criteria, however, these initiatives generally require especially high donor funding to build institutions from (or nearly from) scratch, as well as sometimes-scarce financial expertise.

Project size

A number of projects in the UNDP portfolio are smaller than is normal in microfinance: total budget, including UNDP and other contributions, was below \$500,000 in 17 projects, and below \$1,000,000 in 14 others. UNDP contribution is often quite low, in absolute terms (17 projects had UNDP funding of less than \$500,000) and also in relative terms (UNDP funded half or less of the project in at least 27 cases)¹⁸. Is there a correlation between size and effectiveness? The average grades reveal a mixed pattern.

However, a clearer message seems to emerge when one focuses on the 14 projects rated Good. Where the total project budget was below \$1,000,000, only a single project had a Good grade. The same is true where the UN contribution was below \$500,000. We speculate that the main reason for this pattern is that smaller projects tend to get less serious attention from the Country Office staff. It is probably more difficult to bring in high-quality technical assistance for smaller investments, especially since the present demand for microfinance consultants is stronger than the supply of good ones, with the result that the good ones command high fees. (On the other hand, bigger is not always better. Projects with very large budgets may experience pressure to disburse large sums of money rapidly even where there is not adequate absorptive capacity in the microfinance institutions. This happens because donors are anxious to see funds in the hands of the poor but sometimes unaware of the systematic and sometimes slow process of institutional capacity building required first.)

¹⁸ This number does not take into account projects for which UNDP's contribution was not reported (13 projects)

Table 8
Project Budget and Project Performance

Total Microfinance Budget¹⁹ (\$)	Average Weighted Grade	Total	Good	Weak	UA
< \$100,000	1.50	2 <i>100%</i>	0 <i>0%</i>	1 <i>50%</i>	1 <i>50%</i>
\$ 100,000 - \$ 500,000	1.28	15 <i>100%</i>	0 <i>0%</i>	7 <i>47%</i>	8 <i>53%</i>
\$ 500,000 - \$1,000,000	1.67	14 <i>100%</i>	1 <i>7%</i>	8 <i>57%</i>	5 <i>35%</i>
>= \$1,000,000	2.11	31 <i>100%</i>	12 <i>39%</i>	8 <i>26%</i>	11 <i>35%</i>
NA	1.25	4 <i>100%</i>	1 <i>25%</i>	0 <i>0%</i>	3 <i>75%</i>
Grand Total	1.79	66	14	24	28

Table 9
UNDP Contribution and Project Performance

UNDP Contribution to Project Budget (US\$)	Weighted Average Grade	Total	Good	Weak	UA
< \$100,000	1.85	14 <i>100%</i>	1 <i>7%</i>	8 <i>57%</i>	5 <i>36%</i>
\$ 100,000 - \$ 500,000	1.17	13 <i>100%</i>	0 <i>0%</i>	7 <i>54%</i>	6 <i>46%</i>
\$ 500,000 - \$1,000,000	1.86	10 <i>100%</i>	2 <i>20%</i>	3 <i>30%</i>	5 <i>50%</i>
>= \$1,000,000	2.03	16 <i>100%</i>	6 <i>37%</i>	3 <i>19%</i>	7 <i>44%</i>
NA	1.94	13 <i>100%</i>	5 <i>38.5%</i>	3 <i>23%</i>	5 <i>38.5%</i>
Total	1.79	66	14	24	28

Stand-alone microfinance projects vs. microfinance components

Most of UNDP's microfinance work is done through projects that are focused exclusively on financial services. In some cases, however, microfinance appears as one component in a larger project such as a community development project. The pattern found in this evaluation is striking: not a single component achieved a Good rating. Here again, the

¹⁹ Budget refers to authorized/committed resources

probable explanation is that microfinance components get less attention than stand-alone projects, and perhaps that their financial-service objectives are distorted by the objectives of the rest of the project.

Table 10
Stand Alone / Component and Project Performance

Stand Alone / Component	Average Weighted Grade	Total	Strong	Weak	UA
Stand alone	1.97	50	14	20	16
Component	0.95	16	0	4	12
Total	1.79	66	14	24	28

Technical input for project design

In 48 of the projects it was possible to determine whether or not the country office had help from a technical specialist in microfinance when designing the project. This factor was strongly associated with project success. No project without such specialist input achieved a Good rating.

Table 11
Technical input and Project Performance

	Average Weighted Grade	Total	Strong	Weak	UA
Projects in TA in design	2.27	33	13	13	7
Projects without TA in design	1.00	15	0	3	12

Relative size of microfinance operations in UNDP

Over the years covered in this evaluation, UNDP committed to microfinance an average of \$5.1 million of its own funds per year.²⁰ According to the agency's Multi-Year Funding Framework for 2000-2003, total UNDP commitments averaged \$662.5 million during those years. In other words, microfinance has accounted for a little less than 1% of UNDP's operations in recent years.

However, UNDP is managing more than its own resources. Many microfinance projects involved contributions from other agencies as well, averaging an additional \$12.4 million per year, some of which was managed by UNDP.

²⁰ We were unable to determine the start year for eight projects. In computing annual averages, we allocated funds for those projects equally among the years 1998-2003.

Table 12
Project Budget

Initial Year of Project	# of Projects	UNDP Budget for Microfinance (us\$)		Total Budget for Microfinance (us\$)	
		Total	Average	Total	Average
<1998	6	3,140,000	523,333	8,216,102	1,369,350
1998	9	5,916,887	657,432	36,742,422	4,082,491
1999	13	10,018,149	770,627	43,096,243	3,315,096
2000	10	4,891,500	489,150	8,462,500	846,250
2001	2	20,000	10,000	220,000	110,000
2002	5	3,994,860	798,972	5,664,860	1,132,972
2003	13	4,630,218	356,171	14,524,364	1,117,259
NC	8	6,824,000	853,000	16,102,724	2,012,840
Total	66	39,435,614	597,509	133,029,214	2,015,594

UNDP's comparative advantage in microfinance

UNDP's close relationship with host governments can be an advantage for many areas of development programming. But for the reasons noted above, this relationship is often a distinct disadvantage when it comes to microcredit. The results of this evaluation strongly suggest that UNDP's comparative advantage in microfinance is not some institutional characteristic of the agency, but rather the expertise of the staff in the UNCDF Microfinance unit, which is recognized as one of the strongest headquarters technical units among CGAP's donor members.

UNCDF Microfinance's greatest potential value lies in mainstreaming sound microfinance practice into the operations of UNDP country offices. This potential is underutilized at present, for a number of reasons. The unit prefers to support UNDP Country Offices that have funds to co-invest with UNCDF, and increasingly, Country Offices in LDCs, which are UNCDF's primary target group. This means that Country Offices without new funding to coinvest or in higher income countries are less likely to receive UNCDF advisory services. Additionally, UNCDF has to charge COs for its services, based on fully-loaded costs. On this basis, direct-hire employees of development agencies tend to be more expensive than outside contractors. At any rate, the charges seem prohibitive to some COs. Based on budgetary constraints or HR policies, Country Offices often decide to hire cheaper consultants whose quality turns out to have been uneven at best.

Why has UNDP had problems with microfinance?

With the notable exception of MicroStart and a few of the other TSP projects, UNDP has not been very successful with microfinance. It is important to understand the reasons.

The root problem is not staff incompetence or lack of commitment to doing good work for poor people. On the contrary, this evaluation shows a picture of good people facing incentive, information, and resource problems.

As to incentives, the main issue is that people in the field are rewarded for mobilizing and moving money. The result is that too many microfinance projects are done in circumstances where success is unlikely. Since people rotate so frequently within the agency, it is difficult to hold staff accountable for project results—results that may not be clear until years after the people who were responsible for the decisions have moved elsewhere.

This incentive structure is not likely to change radically. Most or all development funding agencies face a similar problem, to a greater or lesser extent. The problem is recognized and deplored. Occasionally someone tries to fix it, but no one seems to have had a lot of success in eliminating it. Perhaps the problem is inherent in such institutions, so that the best that we can expect to do is to control it, helping people make better decisions by providing them with information about good practices, developing sound corporate guidelines, or creating countervailing incentives such as mandatory performance reporting. During interviews, much mention was made of UNDP's transformation into a knowledge-based organization. Finding effective ways to use knowledge networks and in-house technical expertise to spread information and accumulated knowledge about microfinance remains a key challenge, but significant opportunity.

Another incentive problem has to do with UNDP's relation to host governments. We have already discussed the tensions between government incentives and good microcredit. The issue here is not just the government's formal role in the process of programming funds, but also the fact that a close and supportive relationship with the host government looms large in UNDP's institutional self-image. When the government is anxious to do a credit project in a particular place, or wants to exercise its authority over the operation, it is hard to say no. And any refusal to cooperate with the government entails costs of several kinds.

UNDP staff are often handicapped because they haven't had a chance to acquire basic information about microfinance. As in many other agencies, field staff are beset by a multitude of responsibilities, and their daily schedules don't allow the opportunity or incentive for a lot of self-education in new programming areas. But microfinance is a complex business with some important characteristics that are far from obvious. Donor agencies all have to call on external expertise in most of their microfinance operations. However, experience shows that unless the responsible direct-hire donor staff have a basic literacy in microfinance issues, and have contacts with microfinance specialists inside their own agency, they are not likely to identify and recruit high-quality external experts, or to use them effectively.

These constraints are serious—serious enough to produce bad projects even when smart and committed staff are involved. The good news is that UNDP has at its disposal

approaches that have proven able to compensate for these constraints and produce a high percentage of successful microfinance projects.

Case studies

Attachment 7 contains four brief cases studies of UNDP microfinance projects—two successes and two failures—that illustrate some typical problems and opportunities.

III. Recommendations for management action

UNDP’s Peer Review of its microfinance operations in October 2002 produced a range of useful recommendations (see Attachment 1). The Peer Review recommendations deserve serious attention: indeed, some of them are being implemented already. Rather than reiterating those recommendations, this section will focus on a few crucial lines of action that emerged distinctly and strongly from the new evidence developed in the present project-by-project evaluation. It will be limited to actions for UNDP management. (Recommendations for the line staff who design and manage microfinance projects are laid out in the following section on norms of sound practice.)

A. Announce and implement a policy that UNDP will use the MicroStart model whenever it funds, or administer others’ funding for, retail microcredit operations.²¹

The rationale for this action is simple: the success rate on projects not using MicroStart is unacceptably low. Out of 50 non-MicroStart projects in the portfolio, only two were graded as Good or better.

The policy needs to be precise about what the “MicroStart model” entails. It is probably not practical to require that all UNDP microcredit support participate in the full formal MicroStart programme managed by UNCDF Microfinance. Such a requirement would probably meet with heavy resistance in the decentralized and independent culture of UNDP country offices.

However, the core elements of the MicroStart model can and should be mandated:

- Project implementation is done, or very closely guided by, a technical service provider (TSP) from a pre-qualified list of providers that have already demonstrated their ability to produce sustainable microfinance. UNCDF Microfinance maintains a roster of TSPs with such a track record. Country

²¹ This recommendation is not meant to apply to projects that do not fund retail microfinance operations—for instance, projects focusing on policy advice, technical assistance, or market infrastructure like credit bureaus, auditors, etc. It does apply, however, to UNDP support of “apex” or wholesale funds that loan or grant money for the operations of retail MFIs.

offices that wish to use a TSP not on UNCDF Microfinance roster should review that TSP's qualifications with UNCDF Microfinance.

- There is regular reporting of core performance indicators for microfinance institutions being funded. In practice, the way to insure that such indicators are being meaningfully reported would be to require that semiannual updates of this information in the database that UNCDF Microfinance maintains on MicroStart projects²² In comparison with present non-MicroStart practice, such a requirement would entail a higher degree of management by UNDP staff and the investment of more time and resources in information systems. In some circumstances this degree of oversight may not be practical for the country office. The solution in those cases is to refrain from doing a microcredit project, rather than to do a microcredit project without the monitoring systems that have proven crucial to good performance.
- MFIs that do not meet performance standards are dropped from the programme, unless the technical service provider is confident that MFI managers will correct the problems.
- The country office takes advantage of UNCDF Microfinance technical expertise in the design, implementation, and monitoring of the project. At present, one obstacle that prevents country offices from involving UNCDF Microfinance in their projects is that they have to pay UNDP's fully-loaded costs for UNCDF Microfinance staff time, which makes UNCDF Microfinance staff uncompetitive with external consultants. There are no doubt substantial reasons behind UNDP's overall pricing policy for services of in-house staff. One option might be to make some kind of arrangements, for example a technical assistance fund, for UNCDF Microfinance staff, given the level of problems in the microfinance portfolio. Alternatively, country offices could be asked at least to get input from UNCDF Microfinance in the selection of external consultants.

We recognize that imposing such a policy on country offices' microcredit projects could be seen by some as "headquarters imperialism" that is inconsistent with the general pattern of country office independence in UNDP. The author of this report spent much of his career in donor agency field missions, and as a result sympathizes strongly with skepticism about micromanagement from headquarters, as well as the imposition of endless reporting requirements that do not always lead to more effective interventions. Hence, it is with considerable reluctance that he endorses this recommendation, which

²² Interviews with people responsible for the development of UNDP's new systems for reporting of strategic-level results left us with the impression that the performance of individual microfinance institutions would be hard to fit into that reporting matrix. Thus, we suggest the UNCDF Microfinance database as an alternative. However, UNDP management is in a better position than we are to judge which reporting options are most practical. The important thing is that meaningful performance reporting of core indicators take place. It is not likely to do so across the agency unless the reports are "pasted up on the window"—that is, loaded into a database where everyone can see them.

would substantially limit country offices' freedom of action. However, the dramatic pattern of past results would seem to call for a determined response.

After delivering the original version of this report, the author has learned that UNCDF may be restructured in such a way that its services will no longer be available to a substantial portion of UNDP country offices. If this happens, then it is strongly recommended that UNDP set up an equivalent to the MicroStart programme, including the expert staff to administer it, within UNDP (perhaps drawing on some of the present UNCDF Microfinance staff)..

The "MicroStart model" includes administration by an expert core staff who have a role in

- *Assessing quality of technical service providers,*
- *Reviewing performance reporting to insure that it is meaningful, and*
- *Offering technical advice to the country office.*

Without a programme administered by an expert core staff, any recommendation to apply the MicroStart "model" or the "principles" of MicroStart is likely to fall well short of the intended effect.

B. Maintain the technical expertise that UNCDF Microfinance has built up.

The evidence is that UNCDF Microfinance involvement substantially increases the chances of project success. The support available from this unit appears to have been UNDP's most important comparative advantage in delivering microfinance. This capability should be maintained.

We do not recommend hiring more microfinance specialists. Microfinance amounts to only about 1% of UNDP operations. The present number of specialists should be adequate if country offices have efficient access to their advice, especially if the number of new UNDP microfinance projects year is reduced by screening out the ones where circumstances make success unlikely.

In addition to supporting UNDP operations, UNCDF Microfinance specialists manage UNCDF's own microfinance projects. If the previous recommendation is implemented, this balance will have to be altered, since UNDP's demands on UNCDF Microfinance staff time will increase. **In the general discussions about the future of UNCDF, one of the options being discussed is to reduce or eliminate the Microfinance unit's support function to UNDP country offices. If this outcome occurs, and UNDP does not create its own unit that can provide microfinance expertise to all its country offices,**

it is hard to see how the agency can expect substantial improvement in the effectiveness of its microfinance work.

Should the available microfinance specialists be located in a single unit in New York, or deployed out to regional locations where they are closer to field operations, both geographically and psychologically? Questions like this about location of specialists are argued perennially in many development funding agencies. The factors that argue in each direction are pretty much the same for microfinance as for other specialties. In any event, the evaluation developed no new evidence that bears on this question.

However, the previous recommendation implies the centralization of certain functions. It would probably be hard to implement if most or all of the small UNCDF Microfinance staff were located in individual regions.

UNCDF Microfinance identity and organizational niche may well be altered by decisions about the future of UNCDF. The discussions now underway involve issues far beyond the scope of this evaluation. Thus, our only recommendation on the subject is that the new organizational chart ought to maintain the UNCDF microfinance team or create an equivalent, and locate in a place where it can continue to operate with agility, and replenish its ranks with high-quality people who are selected on the basis of their ability to bring microfinance expertise to bear on the operations of UNDP.

C. Prohibit community-managed revolving loan fund projects.

This revolving loan fund model involves external funding of community-based groups where a credit fund for members operates without substantial oversight and management from the professional staff of a specialized financial institution. The experience of UNDP—and other agencies as well—with this model has been so bad as to justify requiring its abandonment.

D. Consider the possibility of creating a fund, managed by a central technical unit, that supports selected country office projects.

As discussed earlier, implementation of sound practice norms, and more particularly the use of the MicroStart model for all UNDP retail microcredit funding, may well reduce the number of UNDP's microcredit projects. On the other hand, average project size should probably be larger than at present, in order to justify the staff attention, technical support, and information systems that are key to good microfinance. Thus, UNDP could be more selective about project quality without reducing its total resource flow to microfinance.

In this connection, creating a central microfinance fund—probably a trust fund—might have some advantages. Country offices would submit very brief concept papers; the central technical unit would decide which proposals to co-finance, and would be an active partner in the design, implementation, and monitoring of co-financed operations. Selection of proposals to fund would be an ongoing informal process based on

discussions between the country offices and the technical unit, rather than a once-a-year formal competition. This should reduce transaction costs and delays.

Such a fund would move resources to stronger projects, and would improve country offices' incentives to take advantage of the technical unit's expertise. On the other hand, there is some sentiment that tying up resources in such central funds just adds more bureaucracy to the funding process. Further, we did not explore whether feasible sources for such a fund exist. Therefore, we do not make a definitive recommendation on this subject, but we think that the idea merits further consideration.

E. Provide substantive training opportunities for staff that are responsible for managing microfinance programmes.

All projects rated Good had programme managers with substantive training in microfinance. One of the primary reasons for UNDP's weak performance in microfinance is that staff often haven't had a chance to acquire basic information about microfinance. This makes it hard for them to monitor programmes effectively and to recruit good consultants. Many potential recommendations from this Review were floated on the SEMFIN (Small Enterprise and Microfinance Network). UNDP field staff evaluated various recommendations in terms of practicality to implement and likelihood to lead to improvement. The highest score on both counts went to the recommendation to invest in building the capacity of direct-hire staff. While training does not guarantee good projects, good projects almost always have programme managers with basic literacy in microfinance.

IV. Sound practice in microfinance: a brief summary

The purpose of this evaluation was not to develop norms of good practice for microfinance donors. Those norms already exist, having accumulated over several decades of experience with successes and failures in many agencies. Not everyone agrees with all of them, but there is a surprising degree of consensus on them among people with specialized knowledge of microfinance operations. They are documented in many places, only a few of which are cited below.²³

Almost all of UNDP's projects have involved direct or indirect funding of retail microlending to end-borrowers. The good practice guidelines summarized in this section of the report focus on that type of project, and thus do not cover projects that support savings initiatives, policy development, or market infrastructure (such as credit reference

²³ DIRECT Donor Information Resource Centre (<http://www.cgap.org/direct/>); Ledgerwood, J. *Microfinance Handbook: An Institutional and Financial Perspective*, Sustainable Banking for the Poor 1998, available at <http://www.microfinancegateway.org/content/article/detail/1455>; *Building Inclusive Financial Systems: Guidelines on Good Donor Practice in Microfinance* (CGAP Consensus Guidelines, 2004, available at <http://www.cgap.org/docs/donorquidelines.pdf>).

bureaus), or projects that provide technical assistance only. There has been less experience to date with this latter group of projects, and UNDP has done few of them so far. Even within these limitations, the guidelines here are far from a complete list, and occasional over-simplification has been necessary. Some but not all of these guidelines were tested and further validated in this evaluation; in those cases the relevant findings are footnoted. But all these guidelines draw from a base of experience much broader than the set of projects reviewed in this report.

1. Support to retail microfinance should concentrate on developing service delivery that is **sustainable over the long term** and able eventually to tap unsubsidized funds to finance its outreach to very large numbers of poor and near-poor customers. To accomplish this, microfinance providers need to be as efficient as possible, charge interest rates that are high enough to cover all their costs, and maintain very good loan collection.
2. Both microfinance and donor support to microfinance are complex and challenging. The pioneers learned the business on their own, but it is wasteful to repeat their learning curve. Good microfinance is much more likely if there is **specialized expertise both on the donor side and the implementers' side**.
3. There is no substitute for **knowledgeable direct-hire donor staff**. Donor staff don't need to be experts. But those who aren't at least literate about microfinance seldom hire strong external consultants. It is important for an agency to have (and use) a strong central technical unit, and to provide appropriate microfinance training to staff who will be working on microfinance. Projects that are designed without input from qualified specialists seldom succeed.²⁴
4. **Microfinance institutions need to have someone who knows the business**, either someone within their organization, or an experienced external technical adviser who provides in-depth on-the-ground support (i.e., more than an occasional week here and there).²⁵
5. Donors do not create good microfinance—implementing organizations do. Most MFIs do not have the potential to reach sustainability, principally because of management limitations. Donors are mainly bettors, not jockeys or trainers.

²⁴ Of the 12 projects with Good results, all 12 had Country Office staff with some minimum level of training in microfinance. Of the 47 projects where involvement of technical expertise could be assessed, none received a Good rating that did not have specialized expertise involved in project implementation and monitoring. At the same time, the involvement of technical expertise does not necessarily guarantee a good project, especially where implementation is being guided by a technical advisor that does not have a track record of having produced sustainable microfinance, or where meaningful regular reporting is not in place.

²⁵ The best projects in the UNDP portfolio were paired local organizations with technical service providers who had a strong, internationally recognized track record in producing sustainable microfinance with local institutions. In the UNDP portfolio, projects that paired TSPs without track records did no better than projects with no TSP at all.

Their assistance seldom turns weak management into strong management. **A donor's most important function is to recognize and support capable managers** and institutions. Selecting promising MFIs and weeding out poor performers requires a combination of expertise and clearly-defined performance benchmarks.

6. **Monitoring should focus heavily on loan collection.** Collection tends to be a useful proxy for broader areas of management competence. Most loan delinquency is caused by management problems rather than client problems. MFIs that don't collect well usually have other serious problems as well, and are seldom successful in fulfilling their social mission.
7. **Microfinance will not work in all settings.** Many projects fail because they were implemented in unsuitable conditions, for instance:
 - There are no capable local MFIs/managers available
 - No capable technical service provider is available. (The good ones usually have more business than they can handle.).
 - The target region is too unsafe or sparsely populated to permit stable and efficient operations.
 - The intended clients are unlikely to have a stable repayment capacity. (Indebting destitute people with few or no economic opportunities open to them is not a service to them.)²⁶
8. Microcredit is only one way to help poor people. **In many cases, other tools may be more cost-effective**—for instance, direct grants, food-for-work, health and education, etc.
9. Microfinance is much more likely to work well when it is delivered through **institutions that specialize in financial services.**
10. **Donors should give the MFIs they support as much flexibility as possible,** while holding the MFIs accountable for performance. Donors should not build interest rate caps into their projects. They should leave the choice of regions and types of clients to the MFI, if at all possible.
11. Donor agreements with MFIs, including reporting requirements, should focus as much as possible on **achievement of performance targets by the MFI as a whole,** rather than on controlling specific uses of the donor's own funding. Good reporting takes serious planning and work. If setting up a reliable reporting system is impractical, the better option would be to use some other tool rather than microfinance.

²⁶ Of the 20 projects implemented in difficult environments, including conflict or post-conflict settings or remote or very sparsely populated areas, only 1 was rated Good. 10 of the projects were rated unacceptable.

12. An MFI's reporting to the donor, as well as the donor's reporting within its agency, needs to include **reliable information on key performance indicators**—at a minimum, outreach, loan collection, and cost coverage.²⁷ These variables would usually be the most important targets in a performance-based loan or grant agreement with an MFI. Attachment 6 is a guide to calculating and interpreting these indicators.²⁸ Attachment 7 describes how to calculate and interpret the key performance indicators in microcredit.
13. Donors should usually **avoid government involvement in design or implementation of credit projects**. It greatly lowers the odds of success.²⁹
14. Over-ambitious budgets or schedules create **disbursement pressure** that often damages MFIs by interfering with the orderly development of their business and systems.
15. Microfinance should be lodged in **stand-alone projects** wherever possible. Credit components in broader projects tend to receive insufficient attention, and their financial-service objectives can be distorted by other goals in the broader project.³⁰
16. **Community-managed revolving loan funds**, where the community group receives a substantial infusion of external funds early in its life, and lending and collection are not professionally managed/supervised, have such a dismal track record that such projects are practically **never a wise gamble**.³¹
17. Donors should **avoid injecting funds for targeted lending into member-owned, savings-based institutions** such as credit unions or other savings and loan cooperatives. The experience with such projects is that they discourage savings mobilization, they tend to create an unhealthy borrower domination of the institution, and they often get the institution into kinds of credit that it does not know how to manage.
18. Donors should **avoid projects that are too small** to command sufficient attention from donor staff and to allow for recruitment of competent technical advisers.³²

²⁷ Breadth of outreach is measured in terms of number of active clients with loans (or savings accounts, etc.) in force at a specific point in time. In projects that are focused on particularly poor clients, depth of outreach should also be reported. Average loan size (or average outstanding balance) is a very rough proxy for client poverty; other techniques are available that produce a more reliable picture of client poverty.

²⁸ UNDP projects that reported well performed significantly better than those that did not.

²⁹ Of the 12 projects rated good, 11 had no government participation in design or implementation.

³⁰ Not a single microfinance component in a larger UNDP community development project got a Good grade.

³¹ Even though the 14 revolving loan fund projects reviewed were held to lower standards, not a single one was rated Good.

³² Of UNDP's 66 projects, 17 had budgets below \$500,000. Only a single project with a budget of less than \$1 million received a Good grade. On the other hand, very large budgets may create damaging disbursement pressures.

19. Implementing **good-practice principles will probably reduce the number of microfinance projects an agency does**, as projects that don't meet appropriate criteria are screened out.

V. Conclusion

This evaluation and its recommendations deal almost exclusively with direct support to retail microcredit operations, because this has been the predominant focus of UNDP's microfinance work so far. The same has been true for most donors. However, the field of microfinance today is broadening its horizons along several dimensions. More attention is being paid to other financial services that poor people need and use, including savings, remittances, and insurance. As the industry develops, donors are increasingly active in supporting legal and regulatory regimes that favor microfinance development. There is more stress on the importance of market infrastructure such as credit bureaus, audit services, and information technology, and mechanisms for transparent disclosure of financial condition and performance. More basically, there is increasing optimism that many microfinance services can be integrated into the main-line financial system, rather than remaining the preserve of an isolated set of not-quite-banks. These are all good developments.

The future of microfinance in UNDP will be broader than just funding credit operations of individual microfinance institutions. But the credit-focused findings of this evaluation are not quite passé--yet, at least. In the first place, most of UNDP's projects for the next five years or so will probably continue to involve funding of retail microlending, even if the proportion of such projects declines. Secondly, the general experience has been that policy and infrastructure initiatives are much more likely to bear fruit when a solid base of successful retail operations has been established. The same is true of efforts to get main-line institutions like commercial banks to "downscale" into microfinance.

CGAP is very conscious of—and grateful for—the trust that UNDP has reposed in us by asking for this evaluation. We have tried hard to execute it in a way that justified that trust. We hope that our colleagues at UNDP will find it useful.

Attachment 1: Peer Review Report

United Nations Development Programme (UNDP) and United Nations Capital Development Fund (UNCDF) Letter to Management

Executive Summary

A team comprising Nimal Fernando of AsDB, Arlina Tarigan-Sibero of KfW, and Brigit Helms and Alexia Latortue of CGAP, conducted a Donor Peer Review of the United Nations Development Programme (UNDP) and the United Nations Capital Development Fund (UNCDF) in New York from 21-25 October, 2002. The review is part of a 20-agency initiative launched by UK Secretary of State Clare Short and CGAP to tackle aid effectiveness by using microfinance as a test case.

The Peer Review focused on the internal procedures, practices and processes of UNDP to identify success factors and constraints that influence the effectiveness of the agency's microfinance operations. The review also looked at how UNCDF/Special Unit for Microfinance (UNCDF/SUM), the lead technical unit for microfinance in the UNDP group, can best support UNDP's Country Offices and relevant units based in New York. SUM organized meetings with over 60 people from UNDP's Country Offices, including numerous Resident Representatives (RRs) and Deputy Resident Representatives (DRRs), the Sub-regional Resources Facilities (SURFs), Regional Bureaus, the Bureaus for Development Policy (BDP), Management (BOM), and Crisis Prevention and Recovery (BCPR). In addition, meetings were held with the Evaluation Office, Operations Support Group (OSG), Office of Audit and Performance Review (OAPR), the Office of the Administrator, and UNCDF. The team shared initial findings with UNCDF Executive Secretary Normand Lauzon, and UNDP and UNCDF staff on 25 October.

The Peer Review team considered its visit timely, given the on-going UNDP transformation to become a network organization. The review also coincided with the arrival of Peter Kooi as the new SUM Director. The team hopes that this letter to management will contribute specific ideas on how UNDP can improve the quality of its microfinance operations, and how UNCDF/SUM can spread microfinance good practices throughout the UNDP group.

This letter outlines UNDP and UNCDF/SUM's strengths and challenges, and presents a number of specific recommendations for improving quality and effectiveness. A matrix at the end of the letter provides a summary of the key findings and recommendations organized around six strategic areas. The Peer Review team's recommendations fall into five main categories:

- ***Achieve a shared agency-wide understanding of pro-poor financial services.*** UNDP and UNCDF/SUM should develop, and top management should endorse, a common definition of pro-poor financial services and their contributions to poverty reduction and the MDGs.
- ***Improve Accountability.*** UNDP should undergo a portfolio review and integrate transparent mechanisms to improve accountability, as a pre-requisite for results-based management.
- ***Improve Quality.*** As a top priority, UNDP should take concrete actions and provide incentives to improve and consolidate its microfinance portfolio. Uneven quality of operations could threaten the agency's brand name as a whole, not just in microfinance.

- **Retain and strengthen SUM.** The vast majority of SUM's time should be spent on spreading good practices by providing technical assistance to Country Offices.
- **Leverage.** UNDP should leverage its limited resources, experience on the ground, and knowledge infrastructure to become more effective.

Background

Early in 2002, CGAP and DFID's Secretary of State Clare Short launched an initiative to improve aid effectiveness, using microfinance as a test case. As a first step in this initiative, 20 bilateral and multilateral development agencies, including UNDP and UNCDF, volunteered to participate in a series of Donor Peer Reviews. These Peer Reviews are not evaluations or detailed portfolio reviews, but rather focus on each agency's internal procedures, practices, and processes in order to identify success factors and constraints to good practices in microfinance.

The short but intensive reviews result in concrete recommendations for each agency and should lead to commitments by senior management to specific changes that improve the effectiveness of their agency's microfinance operations. It is expected that the analysis and recommendations may also apply to other areas of development assistance pursued by each agency.

A Peer Review team including Nimal Fernando, Lead Rural Finance Specialist of the Asian Development Bank (AsDB), Arlina Tarigan-Sibero, Senior Sector Economist of Kreditanstalt für Wiederaufbau (KfW), Brigit Helms, Lead Microfinance Specialist of the Consultative Group to Assist to Poor (CGAP), and Alexia Latortue, Microfinance Specialist of CGAP, visited UNDP and UNCDF in New York from 21-25, October 2002. The review team interviewed over 60 people. About half the interviews were conducted by telephone to UNDP's Country Offices (including eleven RRs and five DRRs), SURFs and technical partners. In headquarters, the team met with the Regional Bureaus, the Evaluation Office, BDP, BOM, OSG, OAPR, and BCPR. The team also met with Zéphirin Diabré in the Office of the Administrator. Subsequent to the peer review on 20 November, CGAP staff briefed Mark Malloch Brown on the review findings and recommendations.

Follow-up to the Peer Reviews is envisioned both at the agency-specific level and across all agencies participating in the exercise. The review team and CGAP are available to discuss the recommendations contained in this letter in more detail and to support their implementation. The team's findings for UNDP and UNCDF will also be combined with those from other agencies in a synthesis report. Overall results and issues for agencies to tackle jointly will be discussed in various fora involving technical staff and senior management. A final meeting of Ministers and heads of agencies participating in the Peer Reviews will be organized upon completion of all the reviews in 2003 to share experiences and reforms made as a result of the exercise.

This letter outlines UNDP and UNCDF/SUM's strengths and challenges in applying good practice in microfinance. It then presents a number of specific recommendations. Finally, a summary matrix presents key findings and recommendations according to six analytical areas.

Strengths and Implications of UNDP's Transformation

UNDP exhibits a clear commitment to helping developing countries reduce poverty. Internationally lauded for its "Human Development Report," UNDP espouses a holistic concept of poverty that encompasses many dimensions of human development. These dimensions

include income poverty, but also emphasize the need for women's empowerment, equity, social inclusion, and respect for human rights. Moreover, UNDP has joined the international pledge to reach the Millennium Development Goals (MDGs) and to cut poverty in half by 2015.

UNCDF/SUM possesses an equally clear commitment to helping build sustainable financial institutions that serve the poor and those without access to formal, banking services in developing countries.

The visions of UNDP and UNCDF/SUM are compatible when it comes to microfinance. The emerging global vision of microfinance is about ensuring poor people's continued access to a broad range of financial services--savings, credit, insurance, payment systems--thus empowering them to make their own choices about purchasing healthcare, improving shelter, sending children to school, protecting against risks, and building physical and social assets. Adopting a business-like approach centered on achieving sustainability is the only way to ensure that financial services will be available on a permanent basis. Sustainability ensures the on-going social returns of financial services projects.

Strengths

Drawing on this deep commitment to poverty reduction and building sustainable financial institutions, UNDP and UNCDF exhibit the following strengths:

- As a UN organization with international staff and presence in 166 countries, UNDP is considered a neutral, trusted development partner of governments. Resident Representatives (RRs) invest heavily in building close relationships with government officials and generally have good access to them. UNDP is also considered a long-term partner, often staying in countries in turbulent times when other development agencies opt for evacuation. Many UNDP staff believe that the bond of trust it has with governments is the agency's main comparative advantage, especially given the current emphasis on upstream, policy work.
- UNDP's highly decentralized structure reflects the agency's commitment to promoting nationally-owned development solutions. Among the most decentralized of all donor agencies, UNDP values local knowledge and participatory processes that gather inputs from government and civil society at the community levels. UNDP staff often work throughout the countries in which they operate, not only in the capital city. The majority of projects are conceived, designed and approved locally. Because microfinance is an information-intensive activity, being close to the ground helps ensure the development of client-responsive financial services.
- The "UNCDF Working Paper on Microfinance" of 1999 lays out a major shift in the agency's microfinance policy that fully reflects internationally accepted good practices, and provides operational guidelines to identify and build sustainable financial institutions that serve the poor. The microfinance policy includes clear criteria for how and when UNCDF should support financial services for the poor. In addition, UNDP's Operational Policy for microfinance (programme manual) reflects internationally accepted good practices.
- UNDP has privileged access to the excellent technical services of the internationally recognized, dedicated microfinance unit of UNCDF. UNDP staff that have worked with UNCDF/SUM uniformly praise its technical competence and exceptional service. Country

Offices appreciate the proximity and field knowledge of the roving SUM regional advisors as well the unit's vast network of international and local consultants.

- SUM's commitment to development effectiveness and technical rigor is evidenced by the bold step it has taken to close down several poorly performing projects that were present in the UNCDF portfolio before SUM was merged with UNCDF, and to assist UNDP to terminate similar projects. Very few other instances of donors shutting down projects exist. Typically, donors wait out projects' natural end, even when they are ineffective, rather than take the unpopular and difficult decision to close a project early. SUM's actions create a positive precedent and are to be commended.
- SUM's menu of services lay the groundwork for spreading microfinance good practices throughout UNDP. The services run the gamut from supporting a learning agenda (e.g. SEMFIN) and running a capacity building programme to offering technical advisory services (TAS). Through its substantial investment in classroom and distance learning training products, SUM has become one of the few sources of first-rate microfinance training for donors. Numerous donor agencies send their staff to SUM training sessions. MicroStart is an effective vehicle to introduce good practices to countries, foster dialogue among financial intermediaries and to help accelerate the emergence of promising microfinance institutions. MicroStart has incorporated the recommendations of the global mid-term evaluation and is demonstrating more flexibility to support different types of institutions that can reach both sustainability and scale. Through co-investing with UNDP and the TAS, SUM offers highly-valued, hands-on technical assistance.
- UNDP's main instrument, grants, are very flexible and conducive to supporting financial services for the poor, especially in the important area of capacity building. The ability to support relatively small projects (under 5 million USD) is critical for microfinance, and other private sector activities, where technical inputs, not a lot of money is needed. In addition to grants, UNDCF/SUM can also give loans.
- UNCDF/SUM has identified young and emerging markets without a lot of microfinance activity as its niche. Many donors shy from working in emerging markets and with young institutions. Supporting this market niche both builds on the strengths of UNCDF and UNDP, and paves the way for other donors to come in at a later time when the market and/or institutions are more mature.

Implications of UNDP's Transformation

UNDP is in the midst of an operational transformation introduced by the current Administrator with the full backing and commitment of resources on the part of top management. The purpose of the transformation is to improve UNDP's overall effectiveness and flexibility. The vision of a new UNDP focused on information-brokering and systemic results promises significant opportunities to improve the agency's effectiveness in microfinance.

Staff find many of the ideals of UNDP's transformation positive and hope they will materialize. There is a lag, however, between the implementation of the transformation at the policy level and changes in practices at the operational level. The transformation will disappoint if the organizational culture, mindset and incentives are not aligned to match the new philosophy, structure and systems.

A Promising but Incomplete Transformation

	<i>Promising...</i>	<i>...but should consider</i>
Network Organization	<ul style="list-style-type: none"> information infrastructure in place (networks) opportunity for headquarters to add value by providing support services to Country Offices trend towards more technical know-how (SURFs, T system) 	<ul style="list-style-type: none"> staff feel bombarded by too much, sometimes irrelevant and low-quality information lack of clarity on how headquarters can transition from a hub and spoke structure to a demand-driven service center (this would require a new service orientation on the part of staff) institutional culture of distrust and Country Office reluctance to engage with headquarters how to share uniform standards across 166 UNDPs? uneven perception of quality of advice from SURFs weak technical capacity of RR and DRRs and lack of technical career track
Upstream Approach	<ul style="list-style-type: none"> moving from isolated projects to more systemic, policy approach 	<ul style="list-style-type: none"> credibility and effectiveness at the policy level requires solid, grounded, hands-on experience at the retail and meso levels no clear comparative advantage in working at policy level in the financial sector
Results-based Management	<ul style="list-style-type: none"> focus shifting from inputs to development results and outcomes 	<ul style="list-style-type: none"> incentives for good programming and results are weak or non-existent

Challenges

Some aspects of UNDP’s organizational culture and incentive structure pose challenges for its ability to effectively deliver quality development assistance in general.

- There is a mismatch of incentives for staff, especially RRs and DRRs, to mobilize resources and develop close relationships with governments on the one hand, and to ensure the quality of operations on the other. Numerous staff indicate that the incentive for RRs to satisfy requests from governments is stronger than the incentive to heed sound technical advice. The resource mobilization strategy could pose risks if divergent priorities and/or disbursement pressures weaken quality standards.
- The cultural focus and highly-valued RR career track that emphasizes process and partnerships can lead to a neglect of results and development impact. The lack of incentive or career track for staff to specialize in a technical area means that the largely generalist staff are unable to provide technical inputs to projects and adequately supervise consultants. Appropriate technical expertise, however, is necessary to ensure effective microfinance operations. While other donors can learn from UNDP’s participatory approaches, process cannot replace the delivery of demonstrable results.
- Insufficient knowledge is created, shared and used for decision-making. The agency faces several challenges in this regard. How can staff be spared from information overload while

having access to quality, “just-in-time” information? How can network managers strike a balance between creating a welcoming platform for all views while preventing the spread of misinformation or ill-conceived advice?

More specifically, UNDP and UNCDF/SUM face a number of challenges to maximizing their effectiveness in supporting pro-poor financial services.

- Staff at UNDP approach microfinance from multiple perspectives which often leads to the inconsistent application of good practices. Some see microfinance as an input for environment projects or a tool for social mobilization. Others view it as a resource transfer to vulnerable communities, e.g. in post-conflict situations. Few espouse financial systems approach centered on building sustainable financial institutions. It is not uncommon for country missions to have several microfinance projects or components of multi-sector programmes simultaneously, all deploying divergent strategies. These numerous, and often narrow, perspectives are not necessarily negative in and of themselves, but they often result in poor performance and lack of sustainability because of conflicting and mixed objectives.
- This multiplicity of views means that there is no clear articulation of how microfinance can help UNDP achieve its goal of poverty reduction, or how it relates to the Millennium Development Goals (MDGs). Further, in the highly decentralized UNDP, it is unclear how such a vision, were it to be developed, would be disseminated and internalized by staff.
- UNDP’s limited private sector experience poses challenges to working in microfinance which is an inherently private sector activity. Traditionally, UNDP works very closely with governments and often uses ministries for national execution of projects. Experience has shown that in order to have effective microfinance, governments should not be directly involved in the delivery of financial services. This activity is best taken on by private sector actors. The more appropriate role for governments is to help create a supportive enabling environment that allows the private sector to function properly. Donors should support improvements in the enabling environment and/or private entities that provide microfinance. With respect to funding private entities, donors should think and behave more like investors, clearly defining their expected social and financial return on investment.
- Microfinance does not appear anywhere in UNDP’s management structure (ROAR, current information systems, internal audit system, etc.). Pro-poor financial services are neither a practice area nor a service line. Microfinance’s invisibility means that projects with financial services are “tagged” under different names and often do not receive microfinance specialist attention. Yet, microfinance is proliferating in many countries and projects. The ROAR indicates that 77 countries are active in “access to productive resources and assets” and it can be assumed that a large number of these interventions include credit lines or revolving funds.
- Knowledge about the microfinance portfolio is inadequate throughout UNDP. To meet the challenge of results-based management, the agency must have transparent mechanisms to hold itself accountable. Accountability without knowledge of the performance of the portfolio is not possible. The challenge of getting portfolio information has three dimensions. The first is linked to defining microfinance and identifying which projects have microfinance in them. The second dimension has to do with the existing management results framework and its inability to track microfinance-specific relevant portfolio information.

Finally, it appears that institutional incentives for staff to collect portfolio information on a regular and timely basis do not exist.

- UNDP's highly decentralized structure, though very positive in many respects, presents a challenge for quality assurance. Staff repeatedly mentioned that there are virtually no incentives, positive or negative, for individual Country Offices to follow agreed-upon standards. The uneven application of standards within UNDP leads to the substandard quality of microfinance projects and financial components of multi-sector projects. Large credit lines directed at target groups for specific purposes with highly subsidized interest rates persist, as does a culture of low expectation of full reimbursement. Impact is often not achieved, or is time-bound to the duration of a project, i.e. not sustainable.
- Uneven quality of operations threaten the agency's brand name as a whole, not just in microfinance. A poorly performing credit component or revolving loan fund (even a small one) can distort local markets and make it difficult for other donors to support sustainable microfinance programmes, thus undermining support for UNDP from its core donors.
- Safeguards or systematic mechanisms to ensure that microfinance projects or components receive adequate technical inputs do not exist. Country Offices that design and manage microfinance projects and/or components often do not consult appropriate expertise such as qualified technical resources in-country or SUM. When this expertise is tapped, it is often too late in the process. Especially in the case of finance components of multi-sector projects, UNDP staff may not even know that they need microfinance specialist input to avoid creating unsustainable structures and distorting markets. It is very difficult and time-consuming to correct bad practices that are built into project designs.
- Not all Country Offices are familiar with SUM and therefore often choose sub-optimal or no microfinance specialist advice at all. Conversely, SUM does not know the full extent of the UNDP microfinance portfolio. The unit's strong point--its technical skills and rigor--can make it appear unapproachable to some staff, especially those without a financial background and/or knowledge of sound microfinance principles. SUM has not done enough to dispel this perception. There are also questions of how the still largely centralized, small SUM can best serve the highly decentralized UNDP. When Country Office staff consult resources other than SUM, for example the SURFs and locally available consultants, they may be prioritizing proximity, availability for travel on short notice, and local knowledge over quality.
- The potential demand from UNDP for SUM's services is huge and risks overwhelming the unit, especially if SUM reaches out more proactively to Country Offices. A few Country Offices have already been frustrated by the difficulty of getting a SUM staff to their country, although responses to phone calls and emails are always rapid. SUM does not have a clear strategy that defines the manner in which it prioritizes its work (geographically, type of project, etc.) or criteria for how to respond to demands from Country Offices.
- SUM operates within an uncertain budgetary environment. SUM's management does not know its annual budget from year to year. Although SUM is a global service unit that serves all of UNDP, it is constrained to using its own resources in LDCs due to UNCDF's mandate.

Recommendations

The Peer Review team has the following recommendations to build on UNDP and UNCDF/SUM's strengths, and to improve the effectiveness of microfinance operations.

1) UNDP and UNCDF need **to achieve a shared, agency-wide understanding of microfinance**, its contributions to poverty reduction and the achievement of the MDGs, and how best to support sustainable financial services for the poor.

- *Develop Vision Statement that defines and links pro-poor financial services to UNDP and UNCDF's core priorities.* The gap between UNCDF/SUM's clear vision of sustainable financial services and the panoply of views on microfinance within UNDP should be bridged. SUM should take the lead, drawing from UNCDF's microfinance policy, to draft a short *Pro-Poor Financial Services Vision Statement*. The *Vision Statement* should make the case for how building financial systems that serve the poor is important for reaching the MDGs. The statement should be developed in an inclusive manner with full participation from staff in other sectors (e.g. post conflict).
- *Re-affirm commitment from the top.* The *Vision Statement* should be circulated to all Country Offices, SURFs and Headquarters staff with a note of endorsement from the Administrator. This message from the top will help ensure that that the statement is viewed and embraced as a UNDP-wide vision.
- *Integrate into practice areas.* The Administrator's commitment to microfinance should be translated into concrete action by ensuring that pro-poor financial services appear in UNDP's management structure. Pro-poor financial services should be integrated as a service line, possibly under poverty reduction where it currently resides informally. Should a PSD practice area be created in the future, that would be an even more appropriate institutional home given that microfinance is inherently a private sector activity and requires a business-like approach. Embedding microfinance within a PSD approach would by no means diminish its cross-cutting contributions to many sectors such as education, environment, health, and agriculture.
- *Engage RRs and DRRs.* Because RRs and DRRs are the strategy setters and operational leaders with great influence on Country Office operations, a concerted effort should be made to get them to buy-in to the *Vision Statement*. The cluster meetings may be an appropriate mechanism to disseminate the statement. Additionally, a short (approximately, two hour) presentation on the links between pro-poor financial services and poverty reduction should be developed specifically for RRs and DRRs. Additional sessions to expose DRRs with more detailed information on basic good practices, SUM's services, performance indicators and consultant selection may also be appropriate.

2) UNDP should back its commitment to results-based management by integrating transparent mechanisms to **improve accountability**.

- *Conduct UNDP-wide microfinance portfolio review.* The review team congratulates and endorses the Administrator's decision to undertake a portfolio review of UNDP's microfinance operations in 2003. The review should be conducted by an independent third party, with SUM playing a facilitating and supporting role by handling the preparation and data collection process at the direction of the independent party. A prerequisite for a meaningful review is to define criteria for identifying the portfolio, given that many projects with microfinance components are not readily recognizable. It would also be important that

the review compares the actual on-the-ground performance of UNDP microfinance projects both to internationally accepted microfinance standards and to the new vision of microfinance to be developed within UNDP. All relevant staff should be briefed on the purpose of the review as a learning opportunity upon which future decisions on microfinance can be taken. The results should be disseminated widely in the spirit of improving accountability and planning future steps in line with UNDP's objective to increase aid effectiveness and sustainability of development efforts in light of the MDGs. Given UNDP's transformation stage, care should be taken that findings are not misinterpreted by some as a means to assign blame. Significant time and resources should be dedicated to define and implement a post-review action plan.

- *Define and introduce a few, carefully selected performance standards in the management results framework.* UNDP should select a few standards against which to continuously monitor the portfolio's performance, including indicators on portfolio quality, financial sustainability, efficiency, and client outreach. Internationally developed performance standards for microfinance exist, and SUM already has a good microfinance reporting system. These indicators should then be included in the ROAR and ERP. All projects with financial services, whether component or stand-alone, should regularly report the information. SUM should work with Country Offices to make sure that DRRs, project focal points (ARRs, NPOs, JPOs), and advisers understand the rationale behind the chosen indicators. Targeted training for technical implementers and executing agencies on the reporting system may also be required. Finally, the Evaluation Office and Office of Audit and Performance Review should also understand how to check compliance with the chosen targets.

3) Building a framework for accountability is an important step, but UNDP also needs to take concrete actions, including providing incentives, to **improve quality**.

- *Incorporate microfinance expertise early on and often in the project cycle.* All RRs and DRRs should be made aware that high quality microfinance expertise is needed in all microfinance projects or components. Expertise should be involved as early as possible, even before project design. For example, Country Offices should consult with SUM before entering into discussions or negotiations with government officials on microfinance. When SUM is not available, Country Offices should seek its advice on good consultants. In many countries, qualified local consultants are available. Country Offices should use SUM's vast network to identify the best resources. It is better to delay programming than to go without the appropriate technical inputs, despite the fact that this course of action presents risks for RRs who have the often difficult responsibility of mobilizing resources and developing close relationships with governments.
- *Clean up and consolidate the portfolio.* Following the portfolio review, a strategy should be defined to improve the portfolio. In some cases, it may be necessary to close down projects. Closing projects is a difficult and time-consuming task that SUM has already undertaken in several countries. During the consolidation period, the pipeline of new microfinance projects could slow down significantly. UNDP should prioritize the consolidation and learn from mistakes and ineffective projects.
- *Encourage stand-alone microfinance projects whenever possible.* Finance components of multi-sector projects have historically performed poorly across all agencies. Microfinance specialists should collaborate with colleagues in other sectors to understand the needs of populations in specific circumstances, i.e. rural, post-conflict, high HIV/AIDS prevalence

areas. However, the design, implementation and supervision of financial services projects must be done by staff with the proper knowledge and experience of microfinance. For this, financial services should be either stand-alone projects or well-defined and separately managed components.

- *Build on the “T” approach.* The “T” approach to developing deep technical skills in one specific area of the next generation of managers is very positive. Recruiting and training RRs and DRRs interested in specialist knowledge should be continued and accelerated. While managers cannot all become experts in the many UNDP practice areas and service lines, they can become “intelligent consumers” aware of their limitations and armed with questions to ask of specialists.
- *Offer incentives for good practices.* Incentives to encourage staff to seek specialist advice and to increase their own knowledge should be created. For example, Country Offices using the new reporting system or showing the best performance in microfinance could be rewarded with scholarships to international training sessions or their successes could be written up in widely-read UNDP publications.

4) **Retain and strengthen UNCDF/SUM’s role** as a cohesive global unit with the primary task of providing technical services to UNDP’s Country Offices.

- *Retain SUM as a cohesive, global unit with adequate resources to be the microfinance reference point for the UNDP group.* In partnership with UNDP Country Offices, SUM has a critical role to play in improving the quality of microfinance and protecting UNDP’s brand name. Given how quickly the microfinance field is evolving and the need for more work at the vision and strategy level on microfinance within UNDP, it makes sense to keep a critical mass of professionals together in New York.
- *SUM should focus on supporting UNDP in a strategic manner.* Over the medium term (one to two years), the urgent need for improvement is with the UNDP portfolio. SUM should spend the bulk of its time providing services to UNDP Country Offices. SUM should further develop a clear strategy for how it will organize its offer of services to the vast network of UNDP Country Offices. There is likely to be a lot of work following the portfolio review. SUM staff should build on existing services and develop new services and approaches to develop constructive relationships with UNDP staff. Examples include:
 - continue to offer and refine TAS, training and MicroStart products
 - develop a specific strategy to work more effectively with the SURFs, including the maintenance of a regional microfinance expert database
 - segment the market of potential clients within UNDP and craft messages to reach all levels, with a special focus on senior management, RRs and DRRs
 - develop short, operational “how to” notes that are easy to understand on subjects related to financial services for the poor; pay particular attention to areas which UNDP prioritizes, for example, post-conflict, environment, and empowerment
 - establish clear criteria for how Country Offices can access each type of service offered and how resource allocation decisions will be made
 - publicize SUM’s menu of services via existing mainstream UNDP media
- *SUM staff should keep their operational edge by maintaining some strategic direct investments.* It is important that SUM staff have direct control over a pool of their own money for investments, while ensuring that managing them does not consume too much time and does not distract from the priority task of spreading good microfinance practices in UNDP. First, the UNCDF budget for this purpose must be fully clarified to facilitate

planning. In addition, UNDP Senior Management should create and mobilize resources for a Microfinance Trust Fund for UNCDF/SUM to manage, enabling them to work in a more agile way in all countries, including the LDCs. The funds (both UNCDF and the trust fund) would provide SUM with the flexibility to seize opportunities to invest in, for instance, potential “show-how” institutions or to co-invest with Country Offices, providing incentives for adherence to good practices.

- *SUM should increase the number of regional advisors in strategic regions.* The regional advisors should be used to provide decentralized support to Country Offices. They should be recruited and located in a manner that supports the strategy SUM will establish for how best to support UNDP’s Country Offices.
- *Assess feasibility of UNCDF becoming an executing agency.* SUM may be able to support UNDP more directly, quickly and with fewer bureaucratic hurdles if UNCDF were to become an executing agent. A quick cost/benefit analysis should be completed (not a long, complex and drawn out feasibility study) for decision making.

5) UNDP should seek **leverage** of its limited resources, experiences on the ground and knowledge infrastructure to become more effective.

- *Seek technical as well as financial leverage.* UNDP should develop constructive partnerships with other donors to share technical staff in-country, jointly develop microfinance support strategies for countries, and to exchange lessons learned from various experiences. Other donors should not be seen only as a potential source of funds.
- *Enhance quality and application of knowledge for decision-making.* Tools such as the Semfin newsletters and technical replies, short, operational notes, and moderated virtual conferences on specific topics help to transform raw information into useful knowledge. Programme managers should have time built into their terms of reference (TORs) to engage in knowledge management. Moreover, the regional bureaus should ensure that mechanisms are found to exchange lessons learnt across regions.

AID EFFECTIVENESS AND MICROFINANCE MATRIX - UNDP and UNCDF

		Analysis	Recommendations
1.	Strategic Clarity & Organizational Culture	<ul style="list-style-type: none"> • UNDP’s vision: poverty reduction and the MDGs; UNCDF/SUM’s vision: building sustainable financial institutions → visions are compatible with the emerging global vision of microfinance • UNDP’s transformation into a network organization focused on results-based management is positive, but organizational culture, mindset and incentives lag behind • UNDP is a neutral, trusted, long-term development partner to developing countries and enjoys good access to governments • “UNCDF Working Paper on Microfinance” and UNDP operational policy reflects internationally accepted good practices • SUM’s niche: young & emerging microfinance markets • UNDP staff approach microfinance from multiple perspectives leading to the inconsistent application of good practices • No clear articulation of how microfinance can help UNDP achieve its goal of poverty reduction and meeting the MDGs • UNDP’s limited private sector experience poses challenges to working on microfinance, an inherently private sector activity • Microfinance does not appear anywhere in UNDP’s management structure (ROAR, current MIS, internal audit system) • Institutional culture that emphasizes process and partnerships can lead to a neglect of results 	<ul style="list-style-type: none"> • Develop <i>Vision Statement</i> that defines and links pro-poor financial services to UNDP and UNCDF’s core priorities • Administrator should endorse the <i>Vision Statement</i> and circulate it to all New York and Country Offices • Integrate pro-poor financial services as a service line possibly under poverty reduction or, should a Private Sector Development (PSD) practice area be created in the future, under PSD • Engage RRs and DRRs to ensure that they fully buy-into the vision statement through specially crafted presentations and messages
2.	Technical Expertise & Resources	<ul style="list-style-type: none"> • UNDP and UNCDF have privileged access to an internationally-recognized, dedicated microfinance unit, SUM • UNDP Country Offices that have worked with SUM highly value the technical competence of its staff, roving regional advisors, and vast network of consultants • SUM offers a varied menu of services for spreading good practices throughout UNDP, including a learning agenda, capacity building programme, and technical advisory services • Not all Country Offices know about SUM and some find the unit too technocratic and somewhat unapproachable • Potential demand for SUM’s services risks surpassing 	<ul style="list-style-type: none"> • Retain SUM as a cohesive, global unit with adequate resources and a critical mass of professionals in New York • SUM’s priority should be to support UNDP in a strategic manner to help improve its portfolio; SUM should develop a more clear strategy for how it will organize its offer of services to the vast network of UNDP Country Offices; specifically, it should find out how best to work with the SURFs • SUM staff should keep their operational edge by maintaining some strategic direct investments

		<p>capacity; SUM lacks a clear strategy, understandable by all Country Offices, to prioritize its work</p> <ul style="list-style-type: none"> • SUM operates within an uncertain budgetary environment • RRs and DRRs are often technically weak • SURFs are a means to increase technical expertise, but there is an uneven perception of the quality of advice from SURF advisors 	<ul style="list-style-type: none"> • UNDP Management should create and mobilize resources for a Microfinance Trust Fund for SUM to manage, gaining the flexibility to work in non-LDCs • Continue to build on “T” approach • Conduct a quick cost/benefit analysis to study the feasibility of UNCDF becoming an executing agency
3.	<p>Organizational Structure & Flows</p>	<ul style="list-style-type: none"> • Highly de-centralized UNDP values local knowledge which is useful for developing client-responsive financial services • UNDP’s decentralized structure presents challenges for quality assurance across 166 UNDPs • Uncertain how the small, largely centralized SUM can best serve the highly decentralized UNDP • Culture of distrust and Country Office reluctance to engage with headquarters • Information infrastructure exists (networks), but UNDP faces challenges in ensuring that appropriate knowledge is created, shared and used for decision-making 	<ul style="list-style-type: none"> • SUM should increase the number of regional advisors in strategic regions to provide decentralized services to Country Offices • SUM should segment the market of potential clients within UNDP and craft messages to reach all levels, focusing on senior management, RRs, and DRRs • Establish clear criteria for how Country Offices can access each type of service offered • SUM should publicize its menu of services via existing mainstream UNDP media • Build in time for knowledge management in UNDP staff’s TORs

4.	Instruments and Incentives	<ul style="list-style-type: none"> • UNDP’s main instrument, grants, are very flexible and conducive to supporting financial services for the poor • UNDP has the ability to support relatively small projects • Mismatch of incentives for staff to mobilize resources and develop close relationships with governments on the one hand, and to ensure the quality of operations on the other • Highly-valued RR career track that emphasizes process and partnerships serves as a disincentive for staff to specialize • Incentives for good programming are weak or non-existent 	<ul style="list-style-type: none"> • Encourage stand-alone microfinance projects whenever possible • Offer incentives to encourage staff to seek specialist advice and to increase their microfinance knowledge such as offering scholarships and highlighting good performance in UNDP publications • SUM should co-invest with Country Offices, providing incentives for adherence to good practices
5.	Project Cycle	<ul style="list-style-type: none"> • Uneven application of standards across UNDP microfinance projects • Inadequate knowledge of the portfolio makes it difficult for UNDP to meet the challenge of results-based management • systematic mechanisms to ensure that microfinance projects or components receive technical inputs do not exist • SUM has helped closed down poorly performing projects in the UNCDF and UNDP portfolios 	<ul style="list-style-type: none"> • Conduct a UNDP-wide microfinance portfolio review; prepare for the review by defining criteria to identify the portfolio • Define and implement a post portfolio review action plan to clean up and consolidate the portfolio • Define and introduce a few, carefully selected microfinance performance standards in the management results framework (ROAR, ERP) • Incorporate microfinance expertise early on & often
6.	Future Microfinance Operations	<ul style="list-style-type: none"> • Uneven quality of operations threaten brand name of UNDP • UNDP has no clear comparative advantage in working at the policy level in the financial sector 	<ul style="list-style-type: none"> • Seek technical as well as financial leverage from partnerships with other donors

Attachment 2: CO Questionnaire

UNDP PORTFOLIO REVIEW

Origin and Purpose of the Portfolio Review:

In October 2002, UNDP underwent a Donor Peer Review to identify institutional strengths and constraints influencing the effectiveness of UNDP's microfinance operations. This review was part of a 20-agency initiative managed by the Consultative Group to Assist the Poorest (CGAP) to examine aid effectiveness by using microfinance as a test case. The Regional Bureaus shared with you the Review Team's Letter to Management that reports results of the Review and provides key recommendations.

In particular, after concluding that very little knowledge is created and shared about UNDP's microfinance operations globally, the Review Team recommended a comprehensive Portfolio Review to learn more about the depth and quality of UNDP's microfinance operations.

The following questionnaire is the first step in a Review process that will allow UNDP to map its microfinance operations globally, generate lessons about UNDP's diverse experiences in microfinance, and share the network's vast yet often untapped reservoir of knowledge with those implementing programmes on the ground, often in challenging and difficult situations.

The timing of the UNDP Portfolio Review is opportune. The UN General Assembly announced 2005 as the International Year of MicroCredit. The Year will provide an opportunity to highlight the role of microcredit in the eradication of poverty. The Secretary General will soon present a report containing a draft of the programme of action for the effective observance of the year. A transparent presentation of our portfolio, performance and policies in microfinance and their contribution towards poverty reduction will position us well among our development partners and enhance partnership opportunities.

Management of the Portfolio Review:

An independent third Party, CGAP, will design and implement the Portfolio Review. The Administrator has asked UNCDF's Special Unit for Microfinance (SUM) to facilitate the information gathering process. CGAP will draw conclusions from the information gathered, and write a report to highlight their findings.

Purpose of the Questionnaire:

The information collected in this questionnaire will enable the Review team to map UNDP's microfinance activities globally. As such, this questionnaire will not be used to evaluate individual microfinance projects. Rather, it will build a comprehensive picture of UNDP's microfinance portfolio, identify general trends, and ground the selection of projects that will receive in-depth field reviews. Country Offices participating in field reviews will have access to some of the leading experts in microfinance.

Guidelines for Completing the Questionnaire:

We seek information on all microfinance **projects** and **project components**, as well as “**soft assistance**” initiatives that may be delivered through other mechanisms (advisors, workshops, etc.)

Definition of Microfinance:

Microfinance refers to financial services for poor and vulnerable populations, including **credit, savings, insurance, and money transfers**. For the purposes of this Review, *microcredit* refers to loans of money or goods that are meant to be paid back (with or without interest) to a revolving fund, social fund, bank, microfinance institution, NGO, project implementation unit, etc. Please consider any loans smaller than \$2,000 to be microcredit loans. If you are not sure whether a project fits the definition of microfinance, please include it.

Soft Assistance:

In addition to supporting the delivery of microfinance services through Projects, UNDP also provides “soft assistance” by supporting the development of an enabling policy and operating environment for microfinance including donor coordination, building capacity of key stakeholders, and development of policy frameworks.

- One questionnaire should be completed for *each* microfinance project, project component or soft assistance initiative supported by the Country Office.
- Include “**stand-alone**” microfinance projects that focus exclusively on microfinance, as well as **integrated projects** that focus on a range of activities **including a microfinance component**.
- Include projects that are currently **active** as well as any projects that have **been closed within the past two years** (2002 or 2001).
- Include all projects whether they have been **successful, not so successful, or dare we say, failures**. The learning curve for microfinance is steep. We anticipate that some of the most useful insights generated by this Review will probably come from those Projects that were the most challenging to implement.

The questionnaire should take no more than 3 hours to complete.

Time Frame and Contact Information:

Questionnaires should be **received by SUM by September 30, 2003**.

Information in **Hard Copy** can be sent to:

Portfolio Review
Special Unit for Microfinance (SUM/FENU), UNCDF
Two UN Plaza
DC-2, 26th Floor
Room 2619
New York NY 10012

Please send **electronic files** to: PortfolioReview@uncdf.org

The Country Office may send some files by pouch and others electronically, if necessary.

Questionnaire :
Microfinance Portfolio Review

1. Country Office _____
2. Does the Country Office support any microfinance Projects, Project Components, or “Soft Assistance” initiatives that involve the provision of loans and/or other financial services to poor people?

___ Yes
___ No

If yes, please continue with the questionnaire. If no, please return the questionnaire to SUM at PortfolioReview@uncdf.org indicating the Country Office with the “No” response marked.

(If you have multiple Projects related to microfinance, please complete the following questionnaire for each project.)

Part 1: Contact Information

3. Project Name/Number _____
4. UNDP Project Manager _____
5. Phone and email contact of Project Manager (or Person knowledgeable of Project) _____
6. Name and Contacts of key people (UNDP or consultants) involved in project design and implementation (if part of a larger project, only for the microfinance component):
 - a. _____
 - b. _____
 - c. _____
 - d. _____

Part 2: Project Type

For each project, mark the blank (s) that best correspond to the Project.

- **Box 1** describes the most common *organizations* supported by UNDP Projects.
- **Box 2** describes the most common microfinance *services* supported by UNDP projects.
- **Box 3** describes “*soft assistance*” that support **the** development of the microfinance sector
- **Box 4** describes the Project *status*.

Projects supporting multiple institutions may mark more than one blank.

Box. 1: Organizations supported by the Project (responsible for delivering microfinance services to clients)

How many organizations are supported by the Project? _____

For each, check the box that corresponds to its organizational type. On the line provided, write the name of the organization and where the organization operates (region of the country, major cities or towns, etc.)

___ Project (currently without legal status)

___ NGO

___ Cooperative (Financial)

___ Cooperative (Non- Financial)

___ Credit Union

___ Non-Bank Financial Institution (NBFI)

___ Commercial Bank

___ Government owned

___ Private Sector

___ Development Bank

Specialized Microfinance Bank
 Government owned

Private Sector

Community Groups (e.g. , Rotating Savings and Credit Associations, Self Help Groups, other)

Local Government

UNDP Project Implementation Unit (for example, that manages revolving funds or social funds, and provide services directly)

Wholesale or “apex” institution (manages a fund that provides loans or other financial support to retail microfinance institutions)
 Government owned

Private Sector

Other

Box. 2: Services provided to clients/ beneficiaries by organizations in Box 1

- Cash loans/credit (includes interest bearing and interest free loans)
- In-kind loans/credit (for example, seeds or inventory)
- Savings
- Reimbursable “grants”
- Insurance
- Business Development Services with a credit component
- Other _____

Box. 3: “Soft assistance”

- Support for working groups, reference groups, etc. focused on microfinance or financial sector development
- Support to Microfinance networks
- Donor Coordination for microfinance

Training / Capacity Building for stakeholders or government representatives in the financial sector

Other _____

Box 4. Project Status

- Stand-alone project (microfinance only)
- Microfinance component of an integrated or multi-sector project

Pipeline (Estimated Start Date _____ Estimated End Date _____)

Active Project (Start Date _____ End Date _____)

Closed in 2001/2002 (Date closed _____)

Box 5. Practice Area

In which UNDP Practice area does this Project fall?

- Democratic Governance
- Poverty Reduction
- Crisis Prevention and Recovery
- Energy and Environment
- Information and Communications Technology
- HIV/AIDS

Part 3: Project Description

7. Provide a Brief Description of the Project. What were its initial purpose and goals? What problem(s) were you aiming to solve.

If microfinance is just a component of a larger project, how does microfinance relate to the overall project goals?

8. Where applicable, describe the microfinance services offered to clients (savings, loans, etc.). If loans, describe the length of the loans and, the interest rate charged (for example, 3-month loans at 5% per month)) If savings services are offered, are they *voluntary* deposits or *obligatory* savings required as a condition for obtaining loan?

9. Where applicable, indicate which party designed the type and terms of financial services offered to the clients under the project:

_____ UNDP (or consultants for UNDP)
_____ Organization supported by the project
_____ Other (explain): _____

10. Considering the project strategy, is the organization providing financial services expected to eventually cover all its costs with operating revenues from clients (interest from loans, fees, etc.)?

_____ Yes
_____ No

If yes, within how many years after the start of the project?

_____ 1-5 years
_____ 6-7 years
_____ 8+ years

11. Describe the clients served by the organizations supported by the project (target groups, poverty level of clients, etc.) Is reaching the poor a key objective of the project? If so, what information do you have about clients' poverty level?

12. Describe the Project Implementation Arrangements. Who is responsible for carrying out the project's activities on the ground and providing financial services to individual clients? (for example, Microfinance institution, UNDP Project Implementation Unit, UNVs, NGO, consulting firm, multiple entities, etc.)?

13. Who selects the organizations that ultimately provide services to clients and what criteria are used for selection?
14. Does government (local, regional, national) have an active role in the design, implementation and/or monitoring of the project? If so, describe their role.

Part 4. Budget Information

15. What is the project Budget? (Attach a copy of the Project's Summary Budget (if available, but don't prepare anything new.) If microfinance is only a component of the Budget, estimate the amount budgeted for the microfinance.

16. Is UNDP the sole funder of the project?
 Yes No

If not, who are the other donors (please include bilateral / multilateral agencies, foundations, international NGOs, etc.)

Please indicate the size of each institution's overall loan portfolio (this will help give an indication of the institution's size relative to the funding provided by the project.)

Part 5: Performance Information

Please complete Part 5 for *each microfinance organization* supported by the Project. (Where available, please provide information for the institution as a whole -- not only UNDP supported activities, branches, etc. (If the project supports many small community groups (defined as organizations with less than 100 clients each), you may provide consolidated information. If so, please indicate here the number of community groups.)

If you do not collect this information for project monitoring, or if collecting this information would require a field visit, please mark “NC” for not collected

17. Name of institution _____
18. Information as of what date _____
19. Information pertains to
 _____ Overall institutional performance
 _____ Limited to activities, branches, etc. supported by UNDP

Client Information	
20. Number of active borrowers (active loans as of date of information)	
21. % of borrowers that are women (if available)	
22. Number of active <u>voluntary</u> savers (where savings are not tied to disbursement of a loan)	
Lending and Savings Operations	
23. Value of loan portfolio (this is not cumulative loans disbursed, but rather the value of loans ³³ currently lent to clients and not yet repaid)	
24. Value of client voluntary savings (if applicable) – savings that are not tied to disbursement of a loan	
Repayment Performance	
25. Portfolio at risk ³⁴ Indicate the number of days past due in this PAR measurement.	
26. If PAR is not available, please report other indicators, if any, that are used to measure repayment performance (for example, arrears rate, repayment rate). Indicate as PRECISELY as possible how this performance indicator is calculated. Indicator 1 _____	

³³ Loans refers to any funds that will be repaid to the organization (including interest free, interest bearing, reimbursable “grants”, revolving funds, etc.)

³⁴ Portfolio at Risk (PAR): PAR is the outstanding principal amount of all loans that have one or more installments of principal past due by a certain number of days (often 30, 60, or 90 days), divided by the total outstanding principal amount.

Indicator 2 _____	
Sustainability	
For the period _____ to _____	
27. Operational Self-Sufficiency Ratio ³⁵	
28. Financial Self-Sufficiency Ratio ³⁶	

29. Please indicate how the Operating Self Sufficiency indicator is calculated (if the formula used is different than the one provided):

30. Please include here other key performance indicators not captured above:

31. Please indicate the source of the reporting information:

_____ Reports generated by the organization. If yes, indicate the frequency of reports: _____

_____ Reports generated by a third party or external source. If so, identify the source.

32. How would you assess the project’s success to date?

Weak: _____ Moderate: _____ High: _____

33. Briefly explain why:

34. What have been the major challenges in designing and implementing the project?

35. Identify any major bureaucratic or political factors that limited UNDP’s choices in the design and/or implementation of this project?

³⁵ Operational Self-Sufficiency: Interest and fee income divided by total operating costs (including salaries, administrative costs, loan loss provision, interest on bank loans, interest paid to savers, etc.) For example, if interest income is \$50,000 and total operating costs are \$100,000, the operating self-sufficiency ratio is 50%.

³⁶ Financial Self Sufficiency Ratio: Interest and fee income divided by total operating costs (described above) **plus costs related to a) inflation and b) funds at non-subsidized rates**. Calculate the cost of inflation by multiplying the inflation rate by the total equity (minus net fixed assets). Calculate the cost of subsidized funds by multiplying the total funding liabilities (savings, bank loans, etc.) by the commercial cost of funds minus the actual cost paid for funds.

36. Describe any other major challenges to project implementation that limited the ability of the project to perform as well as you anticipated?
37. Has the Project Manager received training in microfinance?

Part 5: Document Request

Please send electronically or in hard copy the following documents to SUM, if available:

- Project Document, including budget
- Performance Reports (Quarterly, Semi-Annual, Annual (as applicable))
- Financial Statements of institution (s) supported (if available)
- Annual Project Report (if available)
- Technical Review (if available)
- Evaluation reports (mid-term, final, outcome evaluation)

Attachment 3: Questionnaire Transmittal
Sample (from RBEC Regional Bureau to RBEC Country Offices)

June 1, 2003

Dear Colleague,

As you may know, UNDP and UNCDF recently underwent a Donor Peer Review conducted by the Asian Development Bank, the German Development Bank KfW, and CGAP -- a consortium of the 29 donor and development agencies most active in microfinance. This review was part of a 20-agency initiative to examine aid effectiveness by using microfinance as a test case. The Review focused on UNDP's internal procedures, practices, and systems, and identified success factors and constraints to implementing good practices in microfinance. UNDP is one of nine agencies to have participated in the peer review exercise so far. The Management Letter prepared by the Donor Peer Review Team which provides key recommendations is attached.

The Administrator of UNDP has pledged that he will act on all our Peers' recommendations. He has agreed that one of the first actions he will support is a comprehensive review of UNDP's microfinance projects and project components. The Peer Review team conducted 60 interviews within UNDP including more than a dozen interviews with Resident Representatives and 10 interviews with Deputy Resident Representatives. The recommendation to carry out a Portfolio Review was largely generated from these interviews.

However, organization-wide consultations indicate that this Review only makes sense as an exercise to help us to achieve a primary corporate goal: contribution towards achievement of the MDGs. To that end, the Review is focused on supporting UNDP strategic objectives towards that goal, specifically, strengthening results and effectively demonstrating those results and their links to MDGs.

To lead the Review, the Administrator has invited CGAP's participation as an independent, third party. He has asked UNCDF's Special Unit for Microfinance (SUM) to play a facilitating and supporting role by handling the preparation and information gathering process.

Based on findings from the Portfolio Review, SUM will design and implement a post-review Action Plan that respond to the technical support and knowledge needs of those implementing programmes on the ground, often in challenging and difficult situations. A Results and Resources Framework that concretely outlines expected outputs and outcomes of the Portfolio Review is attached.

The timing of the Portfolio Review is opportune. The UN General Assembly announced 2005 as the International Year of MicroCredit requesting that the international community give enhanced recognition to the role of microcredit in the eradication of poverty. The Secretary General will soon present a report containing a draft of the programme of action for the effective observance of the year. A transparent presentation of our performance and policies in microfinance and their contribution towards poverty reduction will position us well among our development partners and enhance partnership opportunities.

It is our intent to keep this Review simple and useful to Country Offices and the UNDP network. First, SUM will send each CO a brief questionnaire to complete for each of its microfinance initiatives, including stand-alone projects, integrated projects with credit components and “soft assistance” initiatives (for example, policy advice, donor coordination, etc.) If the CO does not have any microfinance-related activities, simply indicate in the appropriate box on the questionnaire. Following a mapping of the portfolio, approximately 10-12 projects will be selected for in-depth field reviews. COs participating in the field reviews will gain immediate benefits through access to the expertise and services of leading microfinance experts.

It has been demonstrated worldwide that providing people with sustainable access to financial services is a powerful tool to reduce poverty. I am confident that the microfinance Portfolio Review and Post-Review Action Plan will result in stronger microfinance interventions that contribute more effectively to the achievement of MDGs.

The Regional Bureau for the Arab States looks forward to working with you on this exercise, keeping you informed of progress at critical points, and ensuring that you are aware of opportunities that emerge for Country Offices in the areas of training, technical support, and knowledge networking throughout this process.

Warmest Regards.

Attachment 4: Terms of Reference Microfinance Portfolio Review Field Visit

Overview

The field visit will be one of twelve that form part of a review of UNDP's worldwide microfinance portfolio. The purpose of the global review is to assess UNDP's microfinance interventions, to look at how effectively UNDP systems support microfinance, and within the context of improving aid effectiveness, make recommendations to UNDP management on how UNDP can more effectively support the development of microfinance sectors globally.

The product that is needed from this field will be very different from the usual appraisal or evaluation that consultants perform.

For each project, there are basically three tasks

1. Determine if the project has generally performed well.
2. Determine what factors contributed to its success and what factors created obstacles.
3. Determine how UNDP's processes, systems, and practices contributed to its success, or alternatively, hindered achievement of the best possible outcomes.

It is important to understand that this is a zero-risk exercise for the Country Office. The Review Team promises that information about particular countries and projects will not be distributed or included in the review team's report in any identifiable way, unless the CO later gives explicit permission. We hope that the relationship between the consultant and the CO can be a collaborative one, so that the CO can take advantage of the consultant's expertise and experience.

1. Has the Project Performed Well?

For purposes of this portfolio review, what is needed is much less than a full institutional appraisal of the project. The objective is to contribute to an overall view of UNDP's portfolio, *not* to perform a detailed diagnostic. This phase of the work would embrace three elements, not all of which may be practical for all the projects:

The consultant will focus on core performance information, namely, breadth of outreach, depth of outreach, collection, and sustainability.

In the case of revolving loan funds and other credit projects that are not run through a formal institutional intermediary, little performance may be available, and it is usually impossible to calculate sustainability. In such cases, collection performance will be the principal variable.

Adherence to good practice. In addition to or instead of core performance data, most projects can be compared with accepted norms of good practice in microfinance. In new projects, it may not be possible to produce meaningful performance information, and management may not yet have been recruited, so that good-practice compliance may be the only yardstick available.

Assessing the managers. Since project quality involves not only past performance but also future potential, and since management quality is often the main determinant of future potential, the consultant will need to spend enough time with the management of the microfinance operations so that s/he can form a judgment about their competence, vision, integrity, etc.

Assessing “soft” assistance. Some UNDP microfinance projects don’t involve use of UNDP funds to finance retail service delivery—for instance, technical-assistance-only projects or policy advice projects. In such cases, the criteria for project grading will obviously be different. For TA and policy activities, factors would include

- the relevance of the assistance to the actual circumstances and needs: is the project addressing a crucial bottleneck in the country’s microfinance development?
- quality of advice (in the case of policy projects, the advice might be compared with the CGAP Consensus Guidelines on regulation/supervision)
- degree to which advice is implemented
- in the case of TA to MFIs, the extent to which the MFIs receiving the TA have real potential for success
- If the project involves developing a national microfinance strategy, has such a strategy been developed, and is it likely to make an important contribution to the development of microfinance in the country?
- If donor coordination is a key element of the project, is the coordination producing real benefits?

2. What factors contributed to the Project’s success and what factors may have created obstacles to performance?

The sources for this section will typically be the project documentation and contacts with UNDP staff and the other stakeholders who have been involved in the process. Some of those contacts will take place within country, but the consultant should not neglect the

possibility of using telephone and e-mail communication with people who are not available for in-person interviews.

Here is a *non-exclusive* list of factors that should be discussed:

- The role or influence of the government in design and execution.
- More generally, what's the genesis of UNDP's intervention
- Were the microfinance activities designed by whoever was going to be responsible to implement them?
- Was the microfinance activity affected by its association with a particular region or type of client if it was part of a broader project or strategy?
- If microfinance is only one component of a broader project, was there sufficient attention to the quality and sustainability of the microfinance services?
- UNDP's project design, approval, and procurement systems
- Did COs have access to good technical expertise (in-house or external) during design? During implementation?
- What background in microfinance did the UNDP staff responsible for the project have? What specific training, if any, did they have access to?
- Are performance targets/expectations clear, appropriate, and well understood among the parties?
- Is reporting regular, reliable, and relevant to the targets?
- How does the Country Office report on microfinance programme results in the Results Oriented Annual Report (SFR/ROAR)?
- How does the project draw from or share its experiences with the rest of the UNDP network

3. How did UNDP's practices contribute to the project's successes or hamper its ability to achieve the best possible outcomes?

More specifically, how did UNDP practices, policies, decisions, constraints, capabilities affect the performance of the project?

Conceptually, we can distinguish between the performance of project itself, and UNDP's actions/decisions with respect to the project. Obviously, there will usually be considerable overlap between the two. But the consultant is asked to look at these two issues separately for each project.

For example, sometimes UNDP will have made an intelligent decision, and things just didn't work out—or vice versa. Additionally, certain factors within UNDP's organizational structure or rules and regulations may make it difficult for UNDP to make certain kinds of decisions that influence project performance.

4. Output, timing, and procedural matters

Level of effort. Field reviews are expected to require 7-10 days in the field (including travel time) and 3-5 day for advance preparation and report writing, depending on the scope of the project(s) being evaluated.

The consultant is encouraged to make full use of e-mail and telephone in advance of the visit to plan the work, learn about information availability, request meeting arrangements, and perhaps to request that certain information be requested in advance of the visit. This latter point may not always be straightforward, because neither the country office nor UNDP-supported MFIs are paying for the consultant's work.

The consultant should save a half-day of time to allow for requests for clarification and followup from the review team.

Staying in touch with the review team. During the course of the work, the consultant should contact UNCDF two or three times to report the general progress of the work and to resolve questions that arise, including especially situations where time or other practical constraints make it hard to develop all the desired information, and priorities have to be set.

The report will not be published nor circulated beyond the Portfolio Review Team, unless the CO wants to circulate it.

Timing. The report should be delivered no later than two weeks after the conclusion of the field visit, unless a different arrangement has been agreed to in advance.

Protocol. The consultant should begin the exercise by briefing/interviewing the appropriate CO management and staff. This process might well begin by telephone prior to the visit.

In planning the visit, the consultant should strongly request that the CO not schedule, or at least keep to an absolute minimum, "protocol" meetings that are not likely to contribute substantially to the objectives of the field visit.

There should be a final de-briefing with CO staff and management.

The CO should be given the opportunity to comment on a draft of the report before the final version is given to the review team. The consultant will be the sole judge of whether such comments are incorporated in the body of the final report. If there is substantial disagreement between the consultant and the CO, the consultant should append the CO's comments to the final report.

Attachment 5: Grading Protocol

Conceptually, the intent was to grade the quality (or probable eventual) of project results. For most projects, results could not be graded with complete certainty because key performance information was not reported or because the project was too young to allow outcome measurement. In order to fairly reflect this uncertainty, each project's grade was assigned a confidence level—high, medium, or low. (It turned out that average grades did not change materially when they were weighted by confidence level.)

The grader scored each project, based on summaries of the information gathered in the three phases of the study (desk review of file documents, follow-up conversations with task managers of some of the projects, and field visit to a smaller subset).

In cases where there was a field visit to the project, the project was graded both before and after adding the information from the field visit.³⁷

The grading protocol in the box below was also used in an evaluation of World Bank microcredit lines conducted at the same time.

Project grading scale, based as much as possible on results, secondarily on compliance with sound practice norms, and/or management quality:

- A Exceptionally fine project—a star that deserves to be publicized widely as an example of getting things really right. Typically there's a sustainable retailer with demonstrated capacity for massive expansion.
- B Good project: if it involves institutional intermediaries, the project produced or appears likely to produce sustainable service delivery; if no professional institution is involved (e.g., a community-managed revolving loan fund), loan repayment is good enough so the fund doesn't decapitalize quickly
- C Weak but acceptable project
- D Unacceptable project
- E An exceptionally bad project—it does serious damage or is outrageous for some other reason

Conceptually, the distinction among the B (good), C (weak but acceptable), and D (unacceptable) grades is illustrated by the following thought experiment:

You travel back into the past, to when this project was proposed and approved. The project can't go ahead without your approval. As a time traveler, you know exactly how the project will look in 2003. Based on that knowledge, you must check only one of the following statements (no combining)

1. **I actively support** this project. I would be happy to have proposed it myself. If it

³⁷ The purpose of this process was to test the reliability of the desk-review grading. (Addition of field visit information did not materially change the desk-review grades, but did increase the confidence level.)

turned out to need more money, I'd probably be happy to provide it.

2. I wouldn't have proposed this project myself. I'm **unenthused** about it, because doesn't represent sound-practice microfinance. On the other hand, I **won't veto it**, because I'm not sure the odds are good that whatever else the money got spent on would be better for development. But I certainly would be reluctant to see any more money go for this project.
3. I **veto** this project. The money that would have been used on this project should be put in some other activity (not necessarily microfinance); and I think the odds are strong that this as-yet-unknown alternative will probably be better for development than the project being proposed here.

If you checked 1 in the thought experiment, you should grade this project as B (good). If you checked 2, you should grade this project as C (weak but acceptable). If you checked 3, you should grade this project as D (unacceptable).

That's what the grades mean conceptually. But more specifics are needed. It would be impossible to define the boundaries of each grade precisely, but the following indications may help. (Other factors may be considered as well.)

- Ordinarily a credit-line project would get an A (exceptionally good) only if it resulted in a sustainable financial institution that has proved able to (or is clearly positioned to) expand its outreach massively without continuing subsidies. One judges likelihood of future growth based both on past performance and one's assessment of MFI management quality.
- A project with PAR (1 payment period) > 10%, or an Annual Loan Loss Rate > 5%, can never be graded Good or better, unless such rates are a temporary and promptly-corrected spike.³⁸
- A project with PAR (1 pmt period) > 15%, or an annual Loan Loss Rate > 7%, would not be graded Weak but Acceptable or better, unless such rates are a temporary and promptly-corrected spike.
- A project that involves (an) institutional MFI(s) should not be rated Good or better unless it is has reached financial sustainability, or appears reasonably likely to reach it within a reasonable period (5 yrs up to 10 in exceptionally tough cases) after inception. Here again, management quality will be a factor.
- (For early-stage projects there can be no standard norm for level of sustainability, which is affected not only by underutilized capacity during the start-up phase but also by management decisions about the pace of growth. The grader will have to use his/her judgment as to whether MFIs that aren't yet sustainable are likely to get there in a reasonable period of time.)
- **A less stringent performance standard is applied to projects that involve no institutional intermediary—for instance, a community revolving fund**

³⁸ The reason for selecting these benchmarks is experience suggesting that delinquency/default rates higher than these levels are seldom sustainable: the rates have to be brought down quickly or clients' repayment discipline is seriously compromised; otherwise non-payment tends to spin out of control and wind up at levels that make overall financial sustainability impossible. To frame the point from a different perspective, it is highly unusual to find sustainable microfinance retailers whose delinquency or default rates are higher than these levels. In the MicroBanking Bulletin's database of 66 financially sustainable MFIs, the average PAR(30) is 2.8 percent.

projects: such a project cannot be rated Good unless reasonable information indicates that annual loan loss rates for loans to ultimate borrowers is below 10 percent, and cannot be rated Weak but Acceptable unless the annual loan loss rate is below 15 percent.

- A “wholesale” project that funds MFIs cannot be rated Good unless the MFIs it supports, when taken as a group, are producing strong outreach, some of them sustainably. This may be the case even if several of the supported MFIs are unsuccessful.
- A project that that has been justified as reaching especially poor clients cannot be rated Good unless there is some meaningful indication that it is doing so.
- Especially when deciding among Good-Acceptable-Unacceptable, one should if possible compare actual or projected donor spending (not just UNDP’s) with actual or projected loan portfolio (not disbursements). Do the number of clients and the amount of the loans seem a reasonable return to expect from the donor investment?
- Trends in time-series data will be relevant in cases where it is available.

Attachment 6: Core Indicators

[Included in a separate file]

Attachment 7: Case studies

The four highly condensed case studies in this section illustrate successful and unsuccessful UNDP projects. Minor details of the two failed projects have been changed to avoid revealing their identity.

UNDP success story #1:

In a field of amateurs, an island of professionalism-- The case of UNDP Myanmar

Since 1997, UNDP/Myanmar has been supporting three microfinance institutions (MFIs), as part of a deliberate commitment to developing a professional microfinance industry for the country. These MFIs have grown out of three successive UNDP projects, with no other donors involved.

In a difficult economic and political climate, these three organizations have managed to provide loans averaging US\$33 and savings options to over 100,000 clients who represent the poorest of the economically active population of rural Myanmar. The growth in outreach has been matched by an unflinching commitment to maintaining sustainable repayment performance and reaching sustainable cost recovery.

Equipped with robust internal control systems built into daily operating procedures, and detailed and accurate accounting and reporting mechanisms, all three MFIs have achieved a level of administrative efficiency and solid portfolio performance, both elements that hold promise of full sustainability at a scale within their reach. The MFIs' commitment to sustainability is evident in all aspects of the project. Accounting systems and reporting formats are designed to provide clear indicators of progress towards financial self-sufficiency and programme outreach. All indicator calculations are based on CGAP guidelines.

The success of the MFIs is due in large part to the UNDP's strategy, from design to implementation, of accessing quality professional technical assistance. UNCDF Microfinance participated heavily in developing the project design. Three internationally recognized technical service providers have been contracted to provide sustained daily assistance in all aspects of a microfinance operation. The project budgets also finance international training opportunities, thereby giving local staff exposure to international best practices and qualified practitioners. The project documents also ensured an appropriate level of professional experience in the staff responsible for project execution and the UNDP staff responsible for monitoring.

Another important factor for success has resided in UNDP/Myanmar's decision to maintain the integrity of the microfinance programme vis-à-vis the other projects in the country programme that also dispense funds through groups in rural areas. At least three other projects currently have had or still have "credit" or "capitalization" components, and from time to time the country office has considered the relative merits of integrating

the projects. To date, the MFIs have worked in separate areas from the other credit/capitalization projects. The Country Office has been understandably cautious about integrating the microfinance programme with the other credit facilities. This has certainly been to the advantage of the MFIs, as it is very likely that, without adaptation, the presence of the other credit programmes would undermine the disciplined credit culture of the MFIs.

UNDP failure story #1

Despite good intentions

In 1999, the UNDP Country Office decided to support the creation of savings and credit groups in the country's peri-urban and rural areas. The project was part of a larger social governance programme, which included training on income-generating activities, community mobilization, and health education.

Four years and more than \$600,000 into the project, the microfinance results are disappointing. Outreach appears limited, and the lack of reliable records prevents any accurate measure of the number of clients who have received loans. Similarly, the depth of outreach is limited, with signs of elite capture as better-off women use their influence to access the loans. The elite capture phenomenon is closely related to the lax repayment policies. The loans are not collected on a systematic basis, thereby preventing adequate liquidity management and the quick turnover needed to increase outreach and generate income. As a result, the prospects for sustainability without continued outside support are dim. Ad hoc external assistance was provided. Standardized, albeit simple, forms for portfolio management and accounting was introduced. However, managerial capacity in the groups is low. The forms are not filled in regularly, and there is practically no analysis and use of the information they contain.

Monitoring is perfunctory. The one mid-term evaluation report focused mainly on the inputs (loan fund disbursement to the groups, number of training sessions, etc.) rather than outcomes like repayment and sustainability. The occasional reports to the programme manager are rarely acted on. Even when some performance numbers are somehow cobbled together, these go unchallenged.

At the same time, UNDP invested heavily in conferences, training workshops and policy papers at the national level. The gap between the policy theory at the top and the reality on the ground is immense. National policies and strategies have been drafted by international consultants, leading to the creation of follow-up committees by government authorities and donors. Concrete accomplishments by these committees are scarce.

The project suffered from the following flaws:

- **Low donor staff capacity.** The programme manager at UNDP handled a large portfolio of projects beyond the field of microfinance. He had no background in microfinance, and therefore did not have the capacity to analyze the few reports

that he received. Moreover, with many other priorities and mired in the routine of moving papers and attending national workshops, he scarcely had time to monitor the project on the ground. He received no training in microfinance.

- Lack of clarity on final objective. From the beginning, UNDP failed to decide what the project was meant to accomplish: was the credit programme an instrument for social capital? A vehicle for income generating activities? An entry point for other development activities? Or an attempt to build sustainable financial intermediaries? The confusion and the gap between the rhetoric and the means employed led to inadequate planning and insufficient focus on professional practices.
- Early orphan syndrome. Lacking strategic clarity, the project has suffered from insufficient attention, misdirected resources and weak monitoring and backstopping capabilities. The focus on upstream policy work, while theoretically useful, has been disconnected from the realities on the ground, where few programmes have so far received the continuing labor-intensive practical assistance required for a microfinance industry to grow. As a result, outreach in this programme, and nationwide, remains very limited.

UNDP Failure story #2

Wanting to do too much

UNDP supported a large social mobilization programme through the strengthening of community-based organizations (CBOs). This programme had a microfinance component, under which CBOs could receive seed capital and loans for on-lending to their members from local development funds. The programme's other components included training in local governance, income generating activities, and literacy classes. The development funds managed all aspects of the programme.

The programme's objective was to reach the largest possible coverage. When measured against the objective of providing permanent access to financial services to the target populations, the results however were disappointing. Across the CBOs, collection of loans was low and many instances of elite capture were discovered. Spreads were too low to cover even a portion of the management and operational costs of the local funds. CBOs, raising doubts about the programme's sustainability. Without continued outside support, it was unlikely that the CBOs would continue for long. Even though the savings and lending operations were seen as the "glue" holding the local development programme together, those operations instead sowed the seeds of collapse. Mismanagement in some CBOs strained relationships with the groups, as members were put at risk of losing their savings. Any interruption in the provision of financial services caused most members to lose interest in the group and all of its other services.

What went wrong? The programme suffered from a number of weaknesses:

- *Over-ambition*: The aim was 100% coverage within settlements and expansion to more districts, rather than a focus on building strong, well-financed operation in fewer districts. As a result scarce resources were overextended. Budget allocation across an increasing number of recipients became the norm, rather than building resources in a sustainable manner.

- *Isolation*: The programme failed to keep up with current developments in the country's microfinance sector. While the strategy may have been appropriate for the early 90's, by 2003 it looks distant and outdated within the country's microfinance environment. In particular, the programme overlooked the presence of professional local implementers that could have taken over the microlending component and thus taken some of the pressure off the overall programme. Because the programme wasn't well-monitored, the strategy and design were never modified.

- *Lack of monitoring*: The credit operations were never seriously and rigorously reviewed by non-affiliated microfinance experts in or outside of the country. The programme evaluations did not pay sufficient attention to the microfinance operations, nor did they include recognized microfinance people. Thus, the programme was isolated from criticism.

- *Political interference*: the programme structure gave a large role to local public officials. This subjected the microfinance component to political interference and politically motivated decision-making.

- *Lack of technical expertise*: the programme suffered from a lack of technically specialized and/or trained staff at all levels, from the social mobilizers for the CBOs, to the local fund management and to UNDP.

UNDP success story #2

Focused assistance can yield big impact-- The case of UNDP Philippines

UNDP Philippines' "Microfinance Sector Strengthening Project" was designed as a follow up project to the MicroStart programme, through which 16 institutions had received technical assistance from ASA, a leading microfinance institution from Bangladesh. Based on the recommendations of the Global MicroStart mid-term evaluation³⁹ which included the Philippines as a case study, for the second phase (December 2002 - May 2004) UNDP reduced the number of participating MFIs to 3, selecting CARD (NGO), CCT (NGO/cooperative) and LifeBank (rural bank). The criteria included their performance in the 1st phase, their institutional capacity for exponential growth, and the commitment of their leadership and management. All three

³⁹ MicroStart: Finding and Feeding Breakthroughs, Mid-Term Evaluation, UNDP/UNCDF/SUM, Elisabeth Rhyne and Jill Donahue, December 1999.

institutions received technical assistance and mentoring from a team of ASA experts, and visited ASA's operations in Bangladesh.

From a baseline of 59,000 clients in December 2002, combined outreach grew to more than 137,000 clients by June 2004. All three institutions experienced significant growth while maintaining strong portfolio quality (with less than 5 percent of the loans late by more than 30 days), and achieving positive returns on assets even after adjusting for subsidies received.

With a total budget of just over US\$340,000, half of which came from Ausaid, this project showed that a lot can be achieved with little money, if the design and timing are right. The focused approach contrasted with the first phase, where over \$1 million was spread over a large number of institutions.

Beyond the ASA methodology itself, which prioritizes outreach and sustainability over diversity of products, the success of the programme relied on 4 key factors:

The quality of the technical assistance provider. UNDP, with the advisory services of UNCDF's Microfinance Unit, selected a qualified technical service provider with a strong track record in delivering its own microfinance services as well as assistance to other organizations.

The consistency of the technical assistance. The ASA team leader has been present since the beginning of phase I, and the project did not experience significant turnover, allowing for the creation of solid professional relationships and producing greater consistency in the assistance provided. Instead of having consultants coming in and out on an irregular basis with limited accountability, ASA's consultants were on the ground full time. This presence gave them a better understanding of each institution's needs, potential bottlenecks, and required solutions. It also ensured more adequate follow-up in the assistance provided and greater internalization by the institutions.

The design shift. The decision to shift from limited assistance for 16 institutions to focused assistance for three promising institutions concentrated resources where they were likely to produce the most impact.

Regular reporting and monitoring. The three MFIs produce meaningful reports on core performance indicators. Both UNDP and the government partner NAPC have monitored the project actively and faithfully. This arrangement focuses everyone's attention on the objectives that really matter. The Country Office understands where its role begins and where it ends—it has avoided the extremes of excessive intervention or neglect.