

MicroStart:
Finding and Feeding Breakthroughs

Midterm Evaluation

Prepared for UNDP/UNCDF Special Unit for Microfinance

December 10, 1999

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Key to Acronyms

ACDI/VOCA -- Agricultural Cooperative Development International/ Volunteers in Cooperative Assistance

AMAL -- Mutuelle de Crédit et d'Épargne pour les femmes de Bouaflé

AMSSF -- Association for Solidarity without Borders

ASA -- Association for Social Advancement, Bangladesh

CEP-CECREV -- Compte d'épargne et de prêts, compte d'épargne et de crédit

CCT -- Center for Community Transformation, Philippines

CGAP -- Consultative Group to Assist the Poorest

CMEC - Katiola

COFENCI -- Coopérative des femmes entrepreneurs de CI

CTA -- Chief Technical Advisor

FONDEP -- Foundation for Local Development and Partnership

IMEC -- Institute pour les Mutelles d'Épargnes et de Credit

INGO -- International Non-Governmental Organization

IPC -- Internationale Projekt Consult

LTSP -- Local Technical Service Provider

MAB -- MicroStart Advisory Board

MFI -- Microfinance Institution

MIS -- Management Information System

MUCREFAB -- Mutuelle de Crédit et d'Épargne pour les femmes d'Aboisso, B

MUCREFBO -- Mutuelle de Crédit et d'Épargne pour les femmes de Bouaflé

NGO -- Non-Governmental Organization

PAR - 30 -- Portfolio-at-Risk over 30 days

PARMEC -- Programme d'appui à la réglementation des coopératives et mutuelles d'épargne et de crédit (Program to assist in regulating savings and loan cooperatives.)

SCDF -- Seed Capital Development Fund

SCF -- Save the Children Foundation

Socodevi -- Societe de cooperation pour le developpement international

SUM -- UNDP/UNCDF Special Unit for Microfinance

TA -- Technical Assistance

TPKI -- Talete King Panyulung Kapampangan, Inc.

TSP -- Technical Service Provider

UNDP -- United Nations Development Program

UNV -- United Nations Volunteers

USAID -- United States Agency for International Development

XAC -- the Golden Development Fund

I. Introduction

A. *The Midterm Evaluation Process*

UNDP's Special Unit for Microfinance (SUM) commissioned a mid-term evaluation of its MicroStart program to take place in September-October 1999. SUM believed that an evaluation at this time would identify areas for improvement while there was still time to make changes. SUM directed us, as evaluators, to focus on the validity of the assumptions underlying MicroStart and on the processes used to implement it, rather than on the impact of the program.

The evaluation consisted of week-long field visits to three of the longer-standing MicroStart programs: Morocco, Philippines and Ivory Coast. In each country we met with the major participants in MicroStart: UNDP offices, TSPs, LTSPs, MFIs, advisory board members, government policy makers, and experts knowledgeable about local microfinance. In addition to the country visits, we interviewed SUM staff as well as several Technical Service Provider staff. SUM also provided MicroStart documents and recent internal evaluations. Between the additional interviews and documents we were able to develop general pictures of MicroStart in most of the countries where it operates.

This report is organized around five key questions MicroStart's conceptualizer, Henry Jackelen, posed for the evaluation: 1) Does it make sense for UNDP to help launch small and new microfinance organizations? 2) Can technical service providers add significant value to such organizations within the framework offered? and 3) Are small capital grants worthwhile? 4) Can MicroStart have a significant influence on policy and the environment for microfinance? and 5) Is MicroStart a Successful Strategy for UNDP Involvement in Microfinance? The final section of the paper goes through the operational steps in the MicroStart process, making specific recommendations to help implement the ideas discussed in the earlier sections. That section may interest a more limited audience than the rest of the report.

The three country studies, on Morocco, Philippines and Ivory Coast, complete the evaluation report. Those studies show in concrete terms the experience that leads to the recommendations expressed here. Due to the limited time spent in each country, the country studies should be considered case studies rather than full evaluations of the country programs. Nevertheless, where we felt they were warranted we have made recommendations at the country level.

We would like to thank SUM for assistance throughout the evaluation. SUM's team have already recognized and debated most of the issues we raise here. Our contribution comes in providing an outside perspective and systematic investigation. SUM staff showed their commitment to making MicroStart as effective as possible through their openness to discuss all issues and their willingness to listen constructively -- but not passively -- to criticism. We appreciate the support and interaction with each of them: Henry Jackelen, John Tucker, Kiendel Burritt, Deena Burjorjee, Maria Paula Carvajal, and Iain Beattie. We are especially grateful to Heather Clark for her leadership in planning this evaluation, and in encouraging everyone involved to dig deeper, question assumptions, and come up with new ideas. The SUM team reflected her positive attitude. MicroStart Regional Advisors, Anne-Marie Chidzero and Pancho Otero also provided valuable insights. A special thanks is due to Mila Co who smoothly handled contractual and logistical arrangements.

We are also grateful to the people who made our country visits possible, both at UNDP country offices and among TSP and LTSPs (listed in each country report). We learned a great deal

from our intensive conversations with them, and appreciate the time they spent to take care of our logistical arrangements. In addition, we would like to thank staff of ASA, Socodevi, Save the Children, Freedom from Hunger and Calmeadow who commented on their experiences with MicroStart. Finally, we appreciate the willingness of the MFIs we called on to sit with us at length to answer questions of all sorts.

B. Overall Conclusions and Main Messages

Through MicroStart, UNDP is making an important contribution to the growth of microfinance around the world, both through its direct support of MFIs and through the processes and ideas it is introducing into countries where microfinance is just beginning. MicroStart effectively uses UNDP's strengths, particularly its decentralized presence in a wide range of countries. By organizing key players MicroStart brings local leaders into direct, often intense, contact with experienced microfinance providers (the TSPs) and local MFIs. Through this process, best practice ideas are tested and modeled (e.g., appropriate roles for donors and government; interest rate policy; funding mechanisms). As one Moroccan observer noted, MicroStart is introducing rigor into the relations between donors and MFIs, often for the first time. The evaluation affirmed the value of the basic structure MicroStart has set up.

By focusing on young MFIs in countries with less developed microfinance activities, MicroStart has chosen a good niche for UNDP. A particular contribution is bringing southern microfinance organizations into the picture as TSPs, and in encouraging northern TSPs to source more support regionally and locally. MicroStart's main tools -- small grants to MFIs and contracts with TSPs -- are effective mechanisms. The grants do not overwhelm organizations, and their modest size conveys the message that the technical support is more valuable than the money. SUM, which developed and manages MicroStart, is to be commended for creating an effective set of tools, and more recently for taking steps to use them flexibly.

The central recommendation of this evaluation concerns how to get the most benefit from the MicroStart structure. Too often in the course of the evaluation, we found all the wonderful resources of MicroStart being applied to organizations with very low potential. MicroStart aims to work with small, young and promising MFIs, but at the local level the idea of promising is sometimes lost. MicroStart should re-orient the country offices and TSPs toward identifying organizations with the potential to grow and become sustainable -- searching for *breakthroughs*. It must learn the distinguishing characteristics of potential breakthroughs, and it must remove the incentives that still exist to choose low potential MFIs. Where there are few promising organizations, MicroStart will have to work with a smaller number of MFIs, develop strategies for pulling the right people into microfinance, or use MicroStart as a winnowing process.

A second major area of recommendations concerns the structuring of the relationships between the TSP, the MFIs, and the funder. We observed that within the framework MicroStart sets up, capacity building is most effective when the MFI sees the TSP as a partner and values its assistance for its own sake, rather than as a requirement for accessing funding. To enhance this perception, MicroStart should adjust the funding agreements with MFIs to focus clearly on a limited set of objective performance indicators and to base release of tranches on these, rather than on subjective judgments about institutional development. This change will make MFIs more clearly responsible for their own performance while reducing the TSP's role as funding agreement enforcer.

A third important area of recommendations concerns the future activities of SUM. SUM already recognizes that effective MicroStart programs depend on creating ownership within the UNDP

country offices and ensuring that those offices have staff knowledgeable to make sound decisions regarding microfinance. This strategy makes SUM a service provider to the rest of UNDP. SUM's planned capacity building program is an important aspect of this strategy of placing tools in the hands of country offices. SUM staff should focus on providing the best possible service, including more staff visits, focused on the key intervention points it has identified, and limiting involvement during other phases. The evaluation also offers a learning agenda for SUM, based in part on the concept of SUM as a center of expertise for the microfinance industry on young MFIs and in part on topics that have arisen during MicroStart implementation. Finally, the evaluation offers a series of specific recommendations for improving key steps in the MicroStart process.

II. Does It Make Sense for UNDP to Help Launch Small and New Organizations?

The most fundamental question that this evaluation addresses is the validity of UNDP's decision to build a program focused on supporting small MFIs. In its 1999 Business Plan, SUM stated:

SUM made a strategic choice to provide support to start-up and fledgling institutions, including those institutions that aim to develop new products and services. The choice is based on the rationale that meeting the demand for microfinance will require new and young organizations with vision, commitment and capacity to develop sustainable microfinance operations.¹

This and other statements reveal that MicroStart was created to address the immense gap between the potential demand for microfinance services and the actual supply, particularly among the poorer segments of the market, with an emphasis on women.² Its designers believed that in many or most countries existing mature microfinance institutions could not fill this gap and that new organizations were needed. Thus, the sights for the program were set in relation to the demand gap. MicroStart documents emphasized from the first that the organizations should become sustainable and should have the capacity for significant scaling up. The language of venture capital that SUM often used suggested that MicroStart wished to create major successes -- a core idea, which we will refer to as breakthroughs.

On review of the characteristics and early performance of the organizations selected into MicroStart, we can begin to draw conclusions about the validity of SUM's main hypothesis. We conclude that it does make sense to support the kinds of organizations MicroStart hopes to reach. However, to do so, MicroStart programs in the field must substantially reorient their selection processes to focus on organizations that clearly display the characteristics SUM has already identified: vision, commitment and capacity to develop sustainable microfinance operations. This will mean a significantly smaller number of MicroStart participants, but far more productive use of UNDP resources and greater impact for the program overall.

Defining a Breakthrough:

An organization that becomes a major service provider in its geographic area, attaining substantial independence from donors through financial viability and influencing other providers.

A. MFI Performance in Countries Visited: A Few Numbers

Before reviewing the performance of MFIs in MicroStart, it is useful to consider what minimum level of performance would justify the expenditures MicroStart is making. A simple thought experiment can provide us with the roughest order of magnitude. MicroStart programs generally spend \$1.5 million per country, covering both technical and financial assistance. Let us assume that the average loan (or deposit, in the case of credit unions) that assisted programs make is \$100, which is larger than average in some countries and smaller in others. A further (generous) assumption is that MicroStart can claim credit for *all* the additional clients of participating organizations. Finally, we assume that UNDP considers it acceptable to spend a dollar to increase the available amount of loan capital to a poor client by the same amount. This ratio falls well below the leverage ratios heralded by Rich Rosenberg when he pointed out the

¹ SUM, 1999 Business Plan. January - December, 1999.

² Footnote on perceptions about this.

value of leveraging donor resources through licensing of MFIs. However, it is a reasonable or optimistic ratio for working with start-up organizations, and probably exceeds the ratio most donor programs achieve.

In order to achieve this one-to-one ratio, a MicroStart program of \$1.5 million would need its participating organizations to add 15,000 additional clients. These new clients could be stretched out over a longer period of time than the three years of direct MicroStart support, but they should be sustained clients, which would require the organizations to be able to prevent the value of their capital from eroding due to operating shortfalls, loan losses, etc. (otherwise additional grants would be needed to sustain benefits). In order to "justify" the expenditure, therefore, MicroStart programs should not only add at least the requisite number of clients, but also score well on indicators of portfolio quality and financial viability.³

The following table provides a snapshot of MicroStart MFI performance on two key indicators -- client growth and delinquency control -- in the three countries the evaluators visited. Each set of numbers requires interpretation in its own context.

In Morocco, the longest running program, we can see performance over a year and a half. The results must be interpreted in light of the fact that microfinance is very new in Morocco. These are first generation MFIs. Although all the organizations in Morocco have made internal strides as a result of their participation in the program, the success of the program rides on one breakthrough organization: Zakoura. During its MicroStart participation Zakoura has added nearly 9,000 clients, making it the second largest MFI in Morocco, and it has done so while maintaining close rein on delinquency. Zakoura staff expect to reach operational self-sufficiency by the end of this year. On the strength of Zakoura, MicroStart Morocco looks likely to achieve the hypothetical 15,000 client target by the end of the three years.

The remaining organizations, however, have contributed only 4,000 additional clients, half of whom are claimed by an organization, FONDEP, whose numbers are in dispute due to lack of transparency in reporting. Although these organizations are growing, they are all struggling with delinquency problems. Ismailia, the sole program reporting low delinquency, has no regular delinquency tracking system, and its PAR number is not reliable. These programs add little in terms of client numbers, and they are far from sustainable. *Yet they have absorbed four-fifths of project resources.*

Table 1. Growth and Control of Delinquency in MicroStart Institutions Visited

Organization	Clients at Start	Current Clients	Number Added	Quarters in MicroStart	Current PAR-30
Morocco					
Zakoura	2,000	10,730	8,730	6	1.5

³ This exercise provides a very rough estimate, which would vary from country to country. For example in a small, middle income country like Mongolia, the number of clients would be smaller, while the loan size would be larger.

AMSSF	24	988	964	6	23.0
Ismailia	24	479	455	3	3.2*
FONDEP	84	2,360*	2,286*	5	32
AMAL (not visited)	124	479	355	5	18
Total, Morocco	2,256	15,036	12,790		
Ivory Coast					
CEP-CECREV	4	32	28	1	n/a
COFENCI	0	15	15	1	19
MUCREFAB	892	1,444	552	3	21
MUCREFBO	921	1,494	602	3	4.1
CMEC-Katiola	177	490	313	3	0.4
Total, Ivory Coast	1,994	3,475**	1,510		
Philippines					
Bayan Microfinance	3,864	n/a	n/a	1	3.7
TPKI	1,737	n/a	n/a	1	20.9
CCT	2,218	n/a	n/a	1	16.6
Norfil	1,700	n/a	n/a	1	35.0
Other Philippines (13 orgs.)	9,248	n/a	n/a	1	
Total, Philippines	18,767				

*Reported numbers known to be unreliable.

** Total number of members (savers) is 10,553.

In Ivory Coast, the picture is less promising. The situation in the Ivory Coast is dominated by the fact that the participating organizations are all credit unions, and that the TSP is a traditional credit union promotion agency. While MicroStart's standard design focuses on credit delivery, the credit unions focus on savings. There is accordingly some confusion among parties regarding the objectives of the MicroStart program in this instance. This issue will be discussed at greater length later. For now it is important only to note that there do not appear to be any organizations in the MicroStart Ivory Coast program that are likely to become major providers of credit, although two may become significant providers of savings services. Perhaps the Ivory Coast program will meet the "target" on the basis of savers (which would be a good outcome).

The MicroStart program in the Philippines has ambitiously selected 17 organizations to work with, only four of which could be visited during the evaluation. As the program is just starting, no results are yet available. However, it is possible to make some observations about the four selected programs. Of the four, only one, Bayan Microfinance, has the attributes that are likely to propel it toward substantial, sustained growth. The remaining organizations are all multi-purpose organizations whose commitments to microfinance are constrained by stronger commitments to other social goals. All are struggling with delinquency, low growth, and leadership turnover. MicroStart is likely to improve their efficiency, but the gains will probably be incremental. These programs represent the stronger among the group of 17, suggesting that the remaining programs will show fewer results. In the Philippines it is likely that the project will meet the "target" because it is working with so many organizations. The incremental gains will add up. One must ask, however, whether the 15,000 figure is an ambitious enough goal for MicroStart in a populous country with long experience in microfinance.

It is important to note that of all 14 organizations listed here, only four are able to provide a reliable portfolio at risk figure showing that they are substantially in control of delinquency. Given that PAR-30 is the only performance indicator widely available for MicroStart, it is the best available window into organizational potential. It appears from this sample that MicroStart is

beginning mainly with organizations that have significant delinquency problems to overcome, which is usually a very arduous task.

If the trends suggested by these numbers hold, these three MicroStart programs will have achieved the hypothetical target of 15,000 additional clients by the end of their three year lifetimes, but most of those gains will be concentrated in one or two strong organizations per country. Most of the remaining organizations will have added significant numbers of clients relative to their starting points, but the absolute number will be small and the levels of delinquency and operating losses will mean that additional grants will be needed to sustain the gains in client numbers.

There are several important points to note in the preceding discussion:

- MicroStart programs already depend for their success on finding breakthrough organizations. Incremental change is not enough.
- Among the existing portfolios in the countries reviewed, only three organizations look like they will be breakthroughs: Zakoura (Morocco), Bayan (Philippines), and XAC (Mongolia).
- Most of the resources within MicroStart are going to the low-performing organizations, simply because there are so many of them relative to the strong performers.

These observations suggest that MicroStart could greatly enhance its impact if it found a way to focus its energies more efficiently on finding and supporting breakthroughs.

B. What keeps MicroStart from selecting more high-performing organizations?

1. The desire to reach a target number of organizations in each country

The original design of MicroStart called for 5 to 10 participants in each country. These numbers have proven to be too high in most countries. Especially in small countries and in countries where microfinance is relatively new, there are simply not enough promising MFIs to select. In order to comply with the mandate of the program, however, TSPs have filled out the roster with organizations they themselves judged to have low potential. Recently, MicroStart has removed this pressure, making it clear that the number of institutions to assist should be flexible. However, pressure to select a larger number still comes from UNDP country offices and especially from their government counterparts who want to be seen as responsive to as large a number of local organizations as possible. No one likes to be the one who says no to a well-meaning organization. It should go without saying that that pressure from country offices and governments is generally counterproductive, and that TSPs need to make judgments free of external pressures in favor of one or another organization.

2. The belief that weak organizations will benefit more from assistance than strong ones

This is a very influential and pervasive sentiment. The following quotes (some from a UNDP country officer and some from a TSP staff member) state this argument plainly:

- If the institution has strong management....there would be no use providing TA.
- We needed to support weak and small organizations that, almost by definition would have weak management (otherwise, one could argue, why provide TA?).
- How do we know that the strong MFIs wouldn't have attained the objectives without MicroStart support?
- The impact may be greater if we are successful in influencing old and weak institutions to reorient themselves.

Reasoning similar to this nearly led to the exclusion of two of MicroStart's potential breakthroughs (Zakoura in Morocco and Bayan in the Philippines), on the grounds that they were too strong.

In fact, these points contain fallacies that have been proven wrong repeatedly in international experience of working with MFIs. Hard-won lessons about assisting MFIs suggest that:

- The organizations with strong management are exactly the ones who are *most likely* to benefit from technical assistance. Strong organizations are hungry for knowledge about how to run their organizations better. They pick up good ideas and run with them.
- Organizations with weak management often can't implement the good ideas they receive.
- It is extremely difficult for an external TA provider to reorient old organizations. An organization is highly unlikely to shed its own vision and operational culture and adapt a different vision offered by an outsider.

Though organizations may use assistance to improve what they do, their ability to improve will still be limited by who they are.

These observations are borne out by the Morocco program. Evidence of MicroStart's influence abounds at Zakoura. Thus, while one would judge Zakoura as a strong organization with good management, it has made productive use of the learning available through MicroStart. On the other hand, Ismailia, with major management shortcomings, is still struggling to implement the most basic of management improvements and FONDEP, where there is a vision clash with the TSP, still resists basic concepts underlying best practice microfinance.

No one should expect a MicroStart participant to have mastered all the major aspects of operating as a successful MFI. In fact, Zakoura was far from a top-performing organization at the beginning of MicroStart (and still has a long way to go). The key is to learn to distinguish between "small and promising" and "small and weak," and the question for MicroStart is how to equip and motivate the UNDP country offices, TSPs and advisory boards to make such distinctions.

3. Geographic limitations

In some countries MicroStart has been directed to work in specific geographic areas. In Madagascar, UNDP steered MicroStart to the poorer southern end of the country, while in the Philippines it emphasized rural areas and coverage of all parts of the country. The motivations behind such restrictions are often valid -- e.g. to reach poorer areas and ensure that microfinance services are available in more and more locations. In other cases the motives are less justifiable (e.g., where donors have divided a country into zones of influence). However, rigid geographical restrictions are a certain recipe for low results. If geography dominates

selection criteria, organizations will be chosen which otherwise would not be attractive candidates, and which lack critical characteristics. Geographic considerations should figure as only one among a variety of selection factors, and not the dominant factor.

4. Time pressure

In a number of cases the selection suffered from pressure to make selections too quickly. In Morocco, for example, the TSP had one and a half months after being notified of its selection to assess organizations, select participants and negotiate workplans. Because UNDP Morocco risked losing access to future resources (TRAC II) if it did not meet expenditure targets in 1997, it requested Save the Children to complete selection before the end of the fiscal year. The events that led to the time squeeze are understandable and often unavoidable bureaucratic processes. However, a lack of time at this stage truncates the valuable process during which a TSP gets to know the prospective participant. As we will discuss in a moment, important distinguishing factors between promising and non-promising organizations include capability of leaders, compatibility of vision and willingness to be transparent. Judgment about these factors requires more than superficial interaction.

C. *The Art of Selecting Promising MFIs*

As stated above, the key question for MicroStart is whether it can equip and motivate those in charge of MFI selection to choose "small and promising" rather than "small and weak."

Much of the work of the evaluation was devoted to consideration of how to identify breakthrough organizations. The evaluators believe TSPs can do this; however, when the organization is small and young it is more an art than a science. When an organization is small and young, indicators associated with unfulfilled promise may not differ all that clearly from indicators associated with unpromising weakness. In fact, picking winners requires a number of subjective judgments about the people involved in the organization. A combination of objective and subjective judgments is needed. During the MicroStart selection processes, there has been a curious reluctance to make judgments about leadership. It is a sensitive area, and TSPs undoubtedly feel more comfortable relying on objective indicators.

The following points have emerged from many hours of talking with participants in MicroStart, trying to figure out how to pick winners. What has emerged is not a formula, but a set of signals that are probably quite useful.

- **Ownership and Content of Vision.** All the MicroStart programs have included content of vision as an important selection criterion, focusing mainly on commitment to reaching the poor and women, to expansion, and to sustainability. It is crucial to find organizations driven by *strong internal visions of their own* which fit with the MicroStart mandate. Many organizations will endorse MicroStart's vision when the reward for doing so is a grant. That is not good enough. Evidence of internal ownership of that vision is needed. TSPs should assess the depth of the MFI's understanding of what it will mean to embrace this vision. If that understanding is superficial, perhaps educational or exposure activities make sense as a step before selection.
- **Leaders.** As an exercise, we drew up a list of highly successful MFIs from around the world and tried to make generalizations about their origins. Overwhelmingly, a common feature of the successful organizations was that they were launched and

nurtured by extraordinary people. One should consider whether the people leading the organization (e.g., founder, board chair, executive director) have skills, position, and personal characteristics that could put them in the same category as the leaders of some of the better or best organizations. This may be perhaps a sensitive judgment for the TSP to make, but it is absolutely necessary. It is a good sign if leaders have placed some of their own funds at risk.⁴

- **Professionalism.** In order to grow substantially, organizations will have to learn to operate professionally. They will have to develop a paid professional staff for basic management functions. Some small organizations, especially grassroots organizations, operate with volunteers. Although volunteers have a role to play (e.g. on the boards of directors or in some cases at the field level), most organizations will not be able to grow substantially if they depend on volunteers for critical, time consuming functions that require professional skills. While an organization need not have filled all key positions, it should be on the path toward professional operations. Some of the key staff in the organization should have experience in business and/or financial management. Nepotism is also clearly a danger signal.
- **Recent concrete accomplishment.** The organization should have taken steps in the recent past that convincingly demonstrate its commitment to progress. For example, Zakoura had worked informally with international microfinance expert Maria Nowak to implement a lending methodology that worked much better than its original experimental methodology. Bayan staff had traveled to ASA in Bangladesh to learn as much as possible and had begun applying ASA's lessons. The organization should be on an upward, not flat, path. A particular danger signal appears to be organizations that persist in poor performance despite repeated donor assistance. On the other hand, organizations that have rebounded after a serious crisis may have a renewed sense of purpose.
- **Key indicators: control of delinquency, interest rates, and growth.** A small, young organization is not expected to score well on all its performance indicators. New organizations may still be struggling to identify an effective lending methodology and are likely to be at a stage where revenues are far from covering costs. However, organizations should score well on the crucial indicators of delinquency, interest rates and client growth. Lack of good scores in these areas are indications of fundamental weaknesses or signals of vision issues that will be difficult to overcome.

In addition to judgment about an organization's potential, the TSP must also make a judgment about prospects that it can work productively with an organization. Key factors in this assessment are:

- Compatibility of vision.
- Transparency and willingness to share information about the organization's performance, operations and financial condition.
- Openness to learning from an external organization.

⁴ Richard Rosenberg of CGAP summarized his advice on what to look for in the people leading a microfinance institution as follows: ambition, entrepreneurship, competence (brains, leadership abilities, and organizational skills), a concrete vision (beyond dreams), and willingness to learn. Presentation, Third Annual Seminar on New Development Finance, Goethe University, Frankfurt. September, 1999.

- Confidence in the capability of the key person responsible on a day-to-day basis for the MicroStart program. This person should have basic knowledge of microfinance and should have a hands-on work style.

MicroStart has already placed on its learning agenda the desire to distill lessons on how to assist small, young organizations. It is hoped that the reflections given above constitute some contribution to that agenda, and that MicroStart will refine its understanding as it continues.

Finally, MicroStart may wish to give some consideration to the question of who enters microfinance. In countries where the microfinance is new, most people still hold old-paradigm ideas about credit for the poor. In these settings microfinance programs are most likely to originate as add-on projects to multipurpose charitable organizations, or even government agencies. The people who start them may not realize they are entering an area where important lessons have already been learned. A number of the organizations MicroStart has already selected are of this type -- chosen mainly because of a lack of alternatives. Given the importance for MicroStart of finding dynamic, competent people in organizations with a vision aimed at growth and sustainability, MicroStart may wish to consider what can be done to draw potentially strong social entrepreneurs or organizations into microfinance. This question has never received much attention in microfinance circles. MicroStart is well-positioned to examine it. The following box notes two strategies MicroStart has used to pull interesting parties into microfinance, one in a country with no prior microcredit experience (Mongolia), and the other, with more sophisticated partners, in a country with substantial microcredit background (Zimbabwe).

Innovative Selection of MFIs: Microstart in Mongolia and Zimbabwe

In **Mongolia** Microstart found no institutional microcredit services, so it is in the process of creating a new institution. The project began working with the Mongolian Women's Federation and the Liberal Women's Brain Pool, two associations with interest in microcredit, but no real experience. These organizations launched pilot lending operations under the direction of the TSP's (ACDI/VOCA) on-site advisor. At the same time, work began on creating a new financial institution sponsored by these associations and other organizations. The lending is now taking place as part of the institution, XAC (the Golden Fund for Development). This program used the interest and organizational resources of the two associations, but drew its technical knowledge and management skills from the TSP's advisor.

In **Zimbabwe**, Microstart is just launching operations, but its TSP's (Calmeadow) choice of MFIs shows intent to create major successes in a variety of different kinds of institutions:

- Two NGOs featuring dynamic social entrepreneurs: Women Development Credit Scheme and Pondutso
- A private consumer lender wishing to launch microenterprise credit: Nissi Finance
- A savings-based network of 200,000 members: Self Help Development Fund
- A commercial bank with a fledgling microfinance window: Commercial Bank of Zimbabwe

D. Recommendations

This report recommends that SUM reorient MicroStart to focus more clearly on finding and supporting organizations that have good potential to become major providers, while reducing the proportion of its resources devoted to low potential organizations.

1. Reposition MicroStart to emphasize breakthroughs. Use these concepts in interactions with country offices, boards, and TSPs.

Although SUM has talked of venture capital and promising organizations, these ideas have not always penetrated to the level of TSPs and county offices. MicroStart should emphasize throughout its training and promotional materials that it is about finding potential breakthroughs. It should generate lively discussion in its conferences and communications with country offices, advisory boards, and TSPs about how to identify breakthroughs. The new training program for advisory board members already begins to do this. SUM should air debate about hidden assumptions, such as the idea that only weak organizations can benefit from MicroStart.

2. Ensure that MicroStart as implemented at the country level does not impose pressure to select low potential organizations.

This involves removing any remaining requirements for selecting a minimum number of organizations, minimizing geographic restrictions, counseling country offices and boards to allow TSPs to make choices without interference, and ensuring that TSPs are given adequate time to get to know organizations before they are required to submit proposed agreements.

3. Develop mechanisms that turn MicroStart into a winnowing process

Everyone acknowledges that it is impossible to pick winners correctly every time. There will always be organizations in MicroStart's portfolios that are not panning out. MicroStart should develop mechanisms for winnowing out the poor performers and providing more intensive support to the good performers. The reasons for doing this include: (a) more efficient use of MicroStart resources; (b) the incentive effect on participants of knowing that only the good performers will continue; and (c) the fact that even good organizations remain fragile, and may continue to need assistance either to consolidate gains or to continue to move forward. A variety of mechanisms could be considered, such as an extension of a MicroStart program into a second phase that works only with the good performers (as suggested in Morocco), or bonus grants for organizations that meet their targets (as suggested in the Philippines). In new MicroStart programs, the winnowing process could be integrated into the initial design. In countries with few MFIs, MicroStart may even wish to insert a pre-selection phase before including organizations in a full-blown MicroStart program.

III. Can Technical Service Providers Add Significant Value?

The second major hypothesis behind MicroStart is that technical assistance from an experienced microfinance organization or consulting firm can help build the capacity of small, young MFIs. This broad hypothesis begins where the former discussion leaves off, with the observation that the organizations that show vision, leadership, and a willingness to learn are the ones where technical support is most likely to add substantial value. This section deals mainly with a different question -- whether the technical service providers are able to offer good value, particularly within MicroStart's operational framework.

Our general conclusion is that TSPs have a great deal of specific, relevant knowledge to offer, as evidenced by our observation that nearly all of the MFIs are implementing important changes as a result of participation in MicroStart. Involvement in MicroStart may also be important for the TSPs, especially those that are retail MFIs, in helping them to develop their capacity to provide assistance. It is still too early to make generalizations about the effectiveness and impact of the relationships. However, it is not too soon to begin examining the nature of the relationships that are being established and the factors that make them work well.

A. Summary of TSP Performance in Countries Visited

The experiences of the TSPs in each country visited during the evaluation illustrate a range of different issues.

Morocco, with Save the Children as TSP, may be considered a base case, both because it has the longest track record and because the program fits MicroStart's original plain vanilla model. SCF has operated through a series of training workshops followed by on-site visits from the workshop providers. These are supplemented by monitoring visits from the LTSP. Because the selected MFIs are at very different stages, it has been a challenge for SCF to pitch its assistance at the right level. Much of its work with the smaller organizations has focused on lending methodologies while its work with Zakoura has dealt with internal operations and systems. In each MFI visited, there were many clear examples of practices the MFIs had adopted that came directly from SCF's work. In some cases (particularly Zakoura and AMSSF) the organizations gave SCF credit for helping them solve specific key problems that were constraining their growth. One issue in Morocco concerns the elements needed to develop a productive relationship between TSP and MFI. In several cases SCF determined that the conditions for effective transfer of knowledge did not exist and recommended withholding funding from those organizations. Given the lack of clarity in grant agreements concerning conditions under which funds could be withheld, these recommendations caused confusion and bitterness. The other major issue in Morocco, raised by the UNDP office, is that of the high cost of services -- a sense that the \$500,000 TSP contract has not stretched as far as hoped.

The Ivory Coast, as mentioned above, presents an entirely different picture. The TSP is Socodevi, a credit union promotion organization. Socodevi chose to place an expatriate in-country full time, using some of its own funds to supplement the

Management Information Systems

There may be some special considerations regarding MIS systems for very young organizations. In such a program, basic operating systems for managing transactions are often poorly designed -- either too cumbersome, or not providing relevant information, or lacking in appropriate controls. ASA's paper-based system focuses on getting these systems right before moving on to computerization. In other Microstart programs, the search for a workable computer-based MIS has soaked up time and yielded frustration. Perhaps an ASA-type approach makes more sense. SIM may want to place this

MicroStart budget. It focuses on the subjects it knows best: governance and financial management of credit unions. The recipient MFIs have apparently been applying these lessons. The central issue in Ivory Coast concerns the extent to which the MFIs (credit unions) should be required to introduce microfinance credit products -- particularly small group loans to women. The parties in the Ivory Coast, including Socodevi and the UNDP office, are operating under the premise that the purpose of MicroStart is to promote small group loans to women. Accordingly, Socodevi and the MFIs are attempting to add these products. Unfortunately, however, Socodevi staff in Ivory Coast have little experience in this area, and as a result, the organizations are moving ahead with what look like faulty methodologies.

ASA, the TSP in the Philippines has developed a very ambitious program, involving five permanent on-site advisors and 17 participating MFIs, far more of both than any other MicroStart program. ASA's focus is on teaching the Philippine MFIs the secrets of its own success -- a branch operating structure and paper-based management information system based on high efficiency, decentralization, and rapid growth. Its strategy is for each organization launch a pilot branch using the ASA model, with a plan for that branch to cover its costs by the end of one year. During the second and third years of the program the emphasis will shift to determining how or whether to adopt ASA's systems into the mainstream operations of each MFI. Although this program is just getting started, the MFIs unanimously express great enthusiasm for it and praise the value and manner of ASA's assistance. Several have already begun to implement suggestions from ASA into their main operations. The pilot branch strategy has high potential because it engages the MFIs very actively and practically. The main limitations are (a) the limitations of the organizations chosen, which will constrain how far they take what they learn, and (b) ASA's lack of focus on institution building at the senior management level.

A common element in all the countries studied is that the MFIs appear to be implementing suggestions from the organizations. There is no question that the TSPs are having an impact. The question is whether the impact is sufficient to move the organizations substantially forward.

B. Creating Effective Capacity Building Relationships

MicroStart's use of TSPs is an experiment in creating a new framework for capacity building. The original design sprang from the recognition that the standard CTA model in use throughout UNDP projects was not the best way to support the development of microfinance institutions. MicroStart's designers wanted to bring in experienced microfinance organizations. They were especially enthusiastic about involving leading retail MFIs for the first time. Other design features emerged from the practical requirements of working within UNDP. Thus, the original MicroStart model contained some features that reflected a particular philosophy about microfinance (e.g., desire to support local initiative and promote South-South exchange), as well as some features shaped by bureaucratic constraints (e.g., three year time frame, \$500,000 contract amount).

It is useful to compare the MicroStart model with other ways of approaching capacity building in microfinance. The CTA approach has already been mentioned. The MicroStart approach has the potential to bring in greater institutional backing and accountability for performance than is possible with a separately contracted individual. Another model is represented by such early USAID technical assistance projects as Fondomicro in the Dominican Republic, K-REP in Kenya (during the period in which it was an umbrella organization), and Fundacion Covelo in Honduras. MicroStart resembles these efforts in some important dimensions: each was a joint

technical assistance and funding effort, where technical assistance was provided at the same time to several MFIs in a country. Their main lesson has already been discussed, namely that organizations with limited potential are not easily turned around. The experience of these projects led to a view among some experts in microfinance that technical assistance projects do not work. However, MicroStart may have a better chance than those organizations, for two reasons. First, there is today a great deal more specific knowledge about how to do microfinance effectively than there was a decade ago when those projects began. Knowledge transfer may now be a more meaningful process. Second, the MicroStart TSPs that have been selected, unlike the earlier USAID TA providers, have hands-on experience in microfinance. They are probably better equipped to provide relevant, practical suggestions. Nevertheless, one nagging question remains from those experiences -- namely whether the technical assistance framework itself was a limiting factor.

International promoters of microfinance such as ACCION, IPC, FINCA, and others have developed a very different approach to working with MFIs, one which contrasts sharply with the earlier TA project approach and with MicroStart, as shown in Table 2. Most of the international NGOs have concluded that they need to develop long term relationships in which they have substantial influence over the institution or at least over its microfinance operations. Some have chosen to work only with organizations they initiate to ensure compatible vision and strong leadership. One must acknowledge that international NGOs have an element of self-interest in maintaining long term affiliations in which they have significant influence. However, these organizations have come to their current approaches through trial and error, as solutions to some of the central problems involved in capacity building relationships, and their lessons from this experience are important to consider.

The INGO model represents a significant challenge to MicroStart's model, suggesting that effective relationships involve ongoing, rather intensive involvement in operations, management and governance. MicroStart's model is more circumscribed. It implicitly values local autonomy, but it may do so at some cost in terms of concrete achievement.

Table 2. MicroStart and INGO Models of Capacity Building Relationships

Original MicroStart TSP Model	<i>Reasons for MicroStart Features</i>	International NGO Models	<i>Reasons for INGO Features</i>
Limited duration -- 3 years	Standard UNDP project length	Long term affiliation	Organizations have ongoing, evolving needs
Limited control by TSP: MFI retains most control; some control in hands of MAB/UNDP through funding	Desire to support locally-controlled organizations	Varies, but tends towards models where INGO has strong control over the MFI or over its microfinance operations	Ensure that key elements of advice are implemented well; ensure compatible vision
Limited intensity: intermittent assistance	Budget constraint	Varies from very intensive to limited; often personnel stationed inside MFI	Continual presence much better at supporting implementation of advice
Limited span of issues: primarily operational	Difficulty of addressing management issues in this framework	Wider span , usually includes operational issues as well as promotion and management/governance	Biggest constraints are often at management or governance level; ensure compatible vision
Multiple MFIs in one country; may include competitors	Desire to promote sector as a whole	Usually one organization per country ; avoids direct competitors	Avoids conflicting interests
Takes organization as it is -- responsive	Aim to promote local initiative	Generally promotes a particular method and system	Uses what the INGO knows best
Many TSPs are retail MFIs , not service providers	Aim of bringing in ground-level practitioners and promoting South-South exchange	Organizations specifically designed as service providers	Difficult for retail MFIs to free operational staff for technical service provision

MicroStart's model can be characterized generally as a limited, low-control model. It will be an important contribution for MicroStart to watch and analyze its TSP model over the next few years, so that it can draw conclusions about the value of the kinds of relationships it is sponsoring.

Meanwhile, we can already begin to draw conclusions about what works best in the kind of TA framework MicroStart sets up, based on low control and lack of long term affiliation by TA providers.

- **Continuity.** All the TSPs have found it crucial to find a way to provide more regular availability of in-country assistance. ASA (Philippines) provides five in-country experts; Socodevi (Ivory Coast) and ACDI/VOCA (Mongolia) each provide one; and Save the Children (Morocco) uses the LTSP to provide on-site continuity. This is because learning a lesson in a workshop is only the first step in a long, iterative process of internalizing and applying that lesson within the organization. TSP support is needed throughout that process.
- **Doing What They Do Best.** MicroStart should let TSPs do what they do best. Most TSPs have varied the plain vanilla MicroStart model to incorporate elements from the model they normally use, and this freedom is important. Freedom from Hunger and ASA, for example, are teaching organizations their lending methodologies rather than attempting to improve existing methodologies. Within the circumscribed area of the implementation of their models (e.g., the ASA pilot branches), they insist on substantial control. ACDI/VOCA in Mongolia has essentially evolved into a modified-CTA model based on a single on-site advisor working with one organization, reflecting ACDI/VOCA's eclectic approach to microfinance. In the case of Socodevi, this issue is at the core of the program -- i.e., whether Socodevi should be required to teach MFIs group lending, a technique with which Socodevi has little experience. It is important to the success of MicroStart for TSPs to have flexibility, so that they can focus on doing what they do best and working in ways that they understand. This is probably especially important for TSPs who are retail MFIs, whose experience is limited to implementation of their own methods.
- **TSPs Should Not Be Funders.** We found in the Philippines and Morocco that TSP involvement in questions about access to funding either has had or threatens to have damaging effects on the TSP/MFI relationships. ASA has made a point of distancing itself from funding decisions (after MFI selection) in order to ensure that the MFIs remain enthusiastic about working with it. The MFIs are only receptive to advice provided by TSPs when they value the advice for the benefit it provides rather than as a ticket to donor funds. This observation has a direct analogy in the lesson that it is counterproductive to require microentrepreneurs to attend training courses as prerequisite to getting a loan.

The hypothesis that MicroStart may wish to test as the program progresses is that in a framework of low control and limited duration, TA is only effective if the local institution values the TA for its own sake. We envision a three-way relationship in which the donor/MFI link is dominated by objective targets of performance, while the TSP/MFI link is dominated by the MFI's conviction that the TSP can provide means of meeting those performance goals. This model is discussed at greater length in Section IV, on the funding relationship.

C. Other TSP Issues

1. Local Technical Service Provider

The concept of the local technical service provider, although a last-minute addition to the MicroStart framework, is an important part of the whole. However, it needs some modification to make it more workable than the original, overly idealistic concept. Originally, the LTSP was to be a firm, MFI, or individual who would be trained to carry on providing TA to small MFIs after the project ended. This idea was too idealistic because it overestimated the availability of potential LTSPs and underestimated the amount of development that would be required to bring an LTSP to the desired level, especially in countries where microfinance is new. Moreover, it was based on a romantic notion about MFIs helping each other. In Morocco, the idea of stronger MFIs helping weaker ones was built into the design, but has failed, with resulting bad feelings and wasted effort. MicroStart must recognize that most retail MFIs are overwhelmed with the challenges of their own survival and growth, and lack resources to devote systematic effort to assisting other MFIs. Moreover, these other MFIs are potential competitors, and therefore willingness to help will always be constrained. While MicroStart may succeed in involving a few strong MFIs in becoming international TSPs (i.e. mature organizations asked to assist MFIs that will never be their competitors), there is not likely to be an analogue at the local level.

In practice, the LTSP has tended to be an individual, and this person has had to carry quite a burden of logistical support, in addition to learning about microfinance. Nevertheless, these individuals are serving an important function of helping the TSP bridge into the local culture, and often into the local language. In Morocco, the LTSP is the key provider of continuity, given that the TSP operates through intermittent visits. Under this more practical conception of the LTSP's role, the long term role of the LTSP as a service provider is less important than the fact that the person or firm receives a thorough grounding in microfinance. If the LTSP develops credible expertise, local demand for services will be there, and the incentives to use the knowledge gained will be high.

Accordingly, our recommendations for the TSPs are:

- Require TSPs to designate a firm or an individual as LTSP, and to provide the LTSP with high quality training.
- Allow the TSP latitude in the choice of LTSP, the LTSP mechanism, and the use of the LTSP within the project. The only requirement should be that the LTSP must have a substantive, not just administrative or logistical, role. Country offices must refrain from influencing the choice of LTSP.

2. Cost-Effectiveness

MicroStart's designers set the size of the allowable contract for TSPs at \$500,000 per country, a level chosen in reference to the cost of providing a three-year CTA. Contracting provisions associated with pre-qualifying a list of TSPs resulted in fixing this amount as a standard across all of MicroStart. Now, however, TSPs worry that the amount is not enough money to bring about the desired changes, while UNDP officers grumble that the amount of technical support is

lower than it ought to be given the amount of money required. At the risk of being facetious, if one side thinks the amount is too high and the other thinks it is too small, it must be about right! In fact, the evaluators believe the amount is reasonable: sufficient to operate the program, but not without attention to economizing.

Both sides have an incentive to search for greater cost-effectiveness. It is clear that TSPs able to source their technical assistance from within the region, or locally, have important cost advantages over organizations operating primarily out of a developed country. ASA in the Philippines, with five on-site advisors, leaves all the other TSPs far behind in terms of the number of person-hours of technical support it provides. ASA's advantages include: (a) low salaries by international standards, (b) the fact that ASA is regional, reducing travel costs, and (c) ASA's own motivation to prove its capability as an international technical service provider, thus financing some costs out of its own pocket.

In short, the limit on the amount of funds available to TSPs provides a strong incentive to source assistance as close to the country as possible. Since one of MicroStart's objectives is to foster South-South exchanges and the development of local capacity, it should continue to keep a lid on total budgets.

3. TSP Selection Process

The UNDP country offices have -- and should keep -- primary responsibility for the selection of the TSP. However, as most of them have little exposure to the organizations on the TSP list, they rely on assistance from SUM. Two suggestions are made here to improve the selection process:

- Provide more detailed information about the methodologies of the TSPs and the strategies they are likely to use in working with MFIs, and use this information in selecting TSPs that have a good fit to local needs. Instead, the selection, at least according to written documentation, seems to have been based more on loan sizes and the cost-effectiveness of the proposed budget. While these factors are important, it is especially important to understand what the TSP is likely to do once it arrives in the country.
 - In Ivory Coast the UNDP office could have identified Socodevi's lack of experience in providing group loans, negotiating either a credit union development effort without group lending or a strategy for Socodevi to bring in external group lending expertise.
 - UNDP offices selecting Freedom from Hunger or ASA should know that they work with organizations by teaching them their own systems rather than by offering general institutional development assistance. This has been an issue in Haiti, for example.
 - Similarly, they should know that Calmeadow will work with a wide variety of methodologies, and has special expertise in MFI transformation, and that SCDF's main strength lies in helping organizations bring in equity investors.

This information should be presented on a case-by-case basis in a format that allows for a frank assessment. As MicroStart progresses, the relevant information for SUM to pass on will include the performance of TSPs in other MicroStart programs.

- Clarify SUM's role in the selection process. SUM appears to have mixed motives regarding TSP selection. On the one hand, it has strong opinions about which TSPs are a good fit in which countries. On the other hand, it wants to promote a sense of ownership of the choice by country offices. SUM should acknowledge that it has a legitimate role in informing country offices as much as possible about the TSPs, while refraining from pre-empting country office choices. Its views *ought* to influence selection, as SUM knows a great deal more about the TSPs than do the country offices. However, in fairness to the pre-qualified TSPs, SUM must also be careful to ensure that country offices have a chance to consider all the organizations that are interested in working in their country.

D. Recommendations on TSPs

More time must pass before it will become possible to assess the success of the MicroStart framework as a way of working the MFIs, but preliminary indications show that MFIs are enthusiastic about the help they are receiving and are applying lessons. MicroStart has made important innovations to bring more local and regional expertise into the process. It has appropriately allowed TSPs flexibility to work as they best know how. Thus, at this stage the recommendations concerning TSPs are relatively modest:

1. As MicroStart progresses, continue to study the conditions that make for productive capacity building relationships.

Analysts of microfinance have never adequately examined questions about the effectiveness of technical assistance relationships or performance of technical assistance providers. MicroStart offers a unique possibility to analyze a large number of these relationships both for the benefit of MicroStart and for the microfinance field at large. MicroStart may wish to sponsor research on this issue.

2. Modify the Pre-Qualified TSP List regularly.

The TSP list should evolve as the microfinance field evolves -- i.e., rapidly. New organizations are appearing, particularly regional organizations, while some existing organizations on the list are finding that MicroStart is not a good venue for them. Thus, an ideal TSP list today would already have some important differences from the existing list. A rolling qualification and drop out process would be best.

3. Improve the structure of agreements with TSPs and MFIs to enhance the capacity building process.

This recommendation involves clarifying performance targets for both TSPs and MFIs and protecting TSPs from acting as the donor's policeman, in order to ensure that the TSP/MFI relationship maintains the conditions for a free exchange of knowledge. This recommendation is detailed in the next section, on funding.

4. Consider ways for MicroStart to assist TSPs in improving their ability to provide good technical support.

Given that the provision of technical assistance is a new area for many of the TSPs, and that even experienced providers may have little experience working in MicroStart's framework, SUM may wish to consider ways to encourage TSPs to improve their delivery capacity. Two strategies are suggested. One is to be somewhat more demanding of TSPs during the set-up phase -- such as by requiring that TSPs make visits to any country they plan to bid on or by doing more intensive review of the fit between the TSP's know how and the MFI needs. The other strategy is to provide opportunities for TSPs to discuss together issues involved in delivering technical assistance.

IV. Are Small Capital Grants Worthwhile?

The MicroStart approach is to make small grants available to participating MFIs. These grants can be used to cover operating losses or to capitalize loan funds. SUM staff wanted these grants to be a way to funnel small doses of funds in a way that would not overwhelm a small and young MFI's capacity to absorb them. Each grant has a ceiling of \$150,000 and is used for either covering operating losses and/or for loan capital.

A. The Value of TA is Greater than the Value of Money

In each of the country visits MicroStart participants pointed to examples of other donors who wanted to provide loan capital, but were not interested in or capable of supporting long-term technical assistance relationships. Thus, MicroStart occupies a relatively unique position on technical assistance, but on loan capital it is simply one source among several. In fact, some organizations voluntarily participate in the technical assistance component only, and MicroStart should welcome this. In the Philippines about a third of the organizations are participating without receiving any funding, and the remainder stayed in the program even after they learned that they were getting 13% loans rather than grants or recoverable grants. Their continued participation shows how valuable they consider the technical support to be.⁵

The size of the grants is appropriate. For the smallest, newest organizations it may be the first time they have had their hands on enough money to get going seriously. For slightly larger ones, it is enough to ensure that the MFI will take the program seriously, without seriously distorting its behavior. With a larger grant, an organization's staff may pay lip service to technical advice, considering it just another "hoop" to jump through to obtain the money. With small grants, it is easier to tell which institutions are truly committed to growth and accept advice because they believe that it will lead to success—rather than to more donor money.

Finally, given that the MicroStart philosophy is to provide an opportunity to young institutions whose potential for growth is unproven—a small grant is a less risky investment. It won't destroy the institution or bankrupt the donor if the investment turns out to be a bust.

B. Structuring Funding Relationships

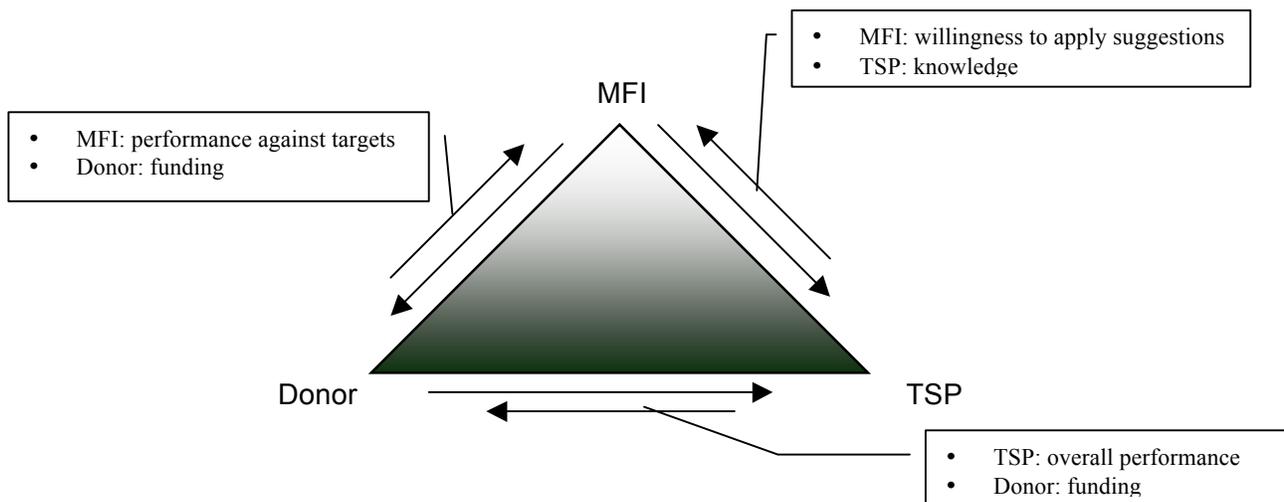
MicroStart has three main actors: the UNDP country offices (with or through the advisory boards) as donors, the TSPs as service providers, and the MFIs. During the evaluation it became clear that in two of the countries visited, funding issues were undermining, or threatening to undermine, the effectiveness of technical assistance provision. As we view MicroStart's primary value added to be on the technical side, we have attempted to identify a funding framework aimed at supporting healthy technical assistance relationships.

Implicitly, MicroStart acted as though the relationships were laid out along a line: the donor contracts with the TSP, who is in turn responsible for selecting the MFIs and for the MFIs' performance. The TSP in that model is the agent of the donor. Performance-based contracts with the TSPs reinforced that idea. However, a triangle is probably a more apt description of the

⁵ In the Philippines, MicroStart's micro-capital grants are funded by government funds, not UNDP's, and are thus subject to government's financial rules

actual relationship (see figure below). The contract with the MFIs, although based on the workplan developed with the TSP, is approved by the advisory board (usually with strong government involvement) and is a contract between the MFI and UNDP. The TSP is not a direct party to the agreement. In a linear arrangement, the only control the TSP has to enforce performance is the threat of withdrawal of funding. However, we do not believe that it is effective for TSPs to use this threat in the MicroStart context. Its use places TSPs into the role of policeman rather than teacher or partner.

In an ideal framework, the TSP would have a mainly technical relationship to the MFIs, after its important role in MFI selection. That relationship would continue as long as both parties consented: i.e., as long as the MFI wished to receive assistance, and as long as the TSP felt that the MFI was responsive to its lessons. The funding relationship would be distinct. The MFI would be responsible to the donor/advisory board for a limited number of objective performance targets. Continued access to funding would be based on the achievement of these targets, not on whether or not the MFI implemented specific suggestions of the TSP. The only role of the TSP in determining whether access to funding should continue would be in certifying the accuracy of the information provided regarding targets. The TSP would still be judged on overall performance targets for the group of MFIs, which would give it an incentive to select MFIs well, define targets carefully, and work assiduously with the MFIs. In fact, the MFI and the TSP would have a joint interest in reaching targets, placing them on the same side, as partners. However, the main responsibility for achieving individual targets would rest where it belongs, with the MFI.



We believe that this type of a funding agreement structure would allocate responsibilities more appropriately and would provide incentives for constructive exchange between the MFIs and the TSP. In order to make it work, the UNDP offices, with the advisory boards, would have to take on a slightly more direct relationship to the MFIs. SUM would need to assist by developing formats for agreements with MFIs that improve on existing agreements in two areas:

- Agreements should explicitly describe the conditions and practices under which tranching funding would be withheld.
- Agreements should establish a small number of indicators as the key performance targets. It is recommended that those indicators include (a) an outreach indicator, such as number of active clients; (b) a portfolio quality indicator, such as PAR-30; and (c) a cost recovery indicator, such as the operational or financial self-sufficiency

ratio. A larger number of indicators would still be reported, but continued access to funding would be based on these three.

There is a requirement for the TSP to report on operational self-sufficiency ratios twice a year, and on portfolio quality and numbers of loan clients every quarter. However, whatever spirit of promoting financial viability exists, in practice there is no required benchmark to reach so that the TSP and MFI can see if they are reaching this goal or not. To really have influence, clear targets need to be set out and negotiated during the contracting process. This will automatically sharpen focus on achieving a portfolio quality, numbers of clients and operational efficiency that will contribute to financial viability.

Although work plans for individual MFIs may have certain targets set out, their contracts have none built into them. This has led to confusion as to how well an MFI is doing. It also makes it impossible to phase out a non-performing institution based on objective criteria that makes it clear to everyone why and when participation in MicroStart should be ended. As it stands now, several organizations reported to the evaluators their complete surprise when the advisory board or the TSP informed them they would be phased out, or that their funding would be held up because of non-performance. This negatively affects the relationship between the TSP and the MFI where the value of technical assistance is lost in the process.

Ideally, targets should reflect the portfolio quality, the operational self-sufficiency and number of active loans. Requiring too many targets is confusing and can become an empty exercise for the MFIs and/or the TSP. In Morocco, Ivory Coast and the Philippines, many MFIs viewed the ratios they report quarterly and bi-annually as something more useful to UNDP than to them. Socodevi in Ivory Coast calculates the ratios on their MFIs behalf because they see it as “information that the donor, and not the MFI, requires”. The accounting manager for MUCREFAB in Ivory Coast stated that she reported the information that went into the ratios and could calculate them, but she had no idea what they meant or how they could be used as financial management tools.

C. Helping MicroStart MFIs with Long Run Funding Strategies

MicroStart grants are clearly not a main funding strategy for most of the organizations. They may be the main strategy for a brief period, but if successful, the organizations will need additional, larger sources of funds within a short time.

When they enter the program, most of the MFIs that MicroStart supports are not dependent on donor funding. Many have local, private sources of funds, usually in small amounts. This means that many of them have had to pay attention to the “bottom line”—keeping costs down and relying on internally generated revenue to cover them. In this environment, financial viability is not an abstract concept, it matters—a lot.

This is a good thing and should not be changed. It would be a shame if MicroStart turned out to be an initiative that merely made it possible for donors to pour huge amounts of money into young MFIs. The purpose of grants to MFIs should not be to fully fund an institution but to provide an opportunity to put the institution on the path towards developing financial viability.

The point of emphasizing financial viability for MFIs is so that they are not dependent on donor funding. MicroStart TSPs should put the spotlight on this and accelerate technical assistance efforts in this area. In addition, MicroStart TSPs should also assist the MFI to cultivate funding relationships with private sources of funding early on. For example, Zakoura in Morocco is

beginning to do this with commercial banks through its founder who is an influential businessman. For now, the loans are interest free, but Zakoura is preparing for the day when it will need to pay for this money. MUCREFAB in Ivory Coast is also trying to negotiate terms with a bank, BOAD, to increase the size of its loan capital.

Long run MFI funding strategy is an area where SUM should provide guidance and information. Even the TSPs are often weak on this topic, and in-country perspectives are often limited. Without alternate strategies, the default option will probably turn out to be reliance on donors.

D. Flexibility on Funding

Thus far, MicroStart is applying a generic funding level to most MFIs. Whether they need it or not, or can absorb it or not, an MFI receive the \$150,000 Micro-capital grant. Some exceptions deserve mention here. In Ivory Coast, CMEC-Katiola received only \$6,000 to buy some equipment and cover some operational costs to enable them to establish a solid accounting system. Any future money is contingent on its success in doing so. In the Philippines, some MFIs are not receiving any grants at all; in these cases, the MFIs get only technical assistance from the TSP. Flexibility in determining initial funding levels would be useful. The TSP could then more effectively tailor the assistance a given MFI receives.

Creating some type of mechanism whereby phased injections of additional funding is possible would also be important. MicroStart bets on institutions before their true potential is known, and it is only natural that some of the bets don't deliver. This is in keeping with the idea in section II about making MicroStart more of a winnowing process. Similarly, since institutions are young, three years and \$150,000 may not be enough. For those who have proven their potential, another phase of modest funding and technical assistance may sometimes be in order. It is important, though, that any additional attention to an MFI is directly linked to the actual progress towards financial viability, operational sustainability and expanding outreach to clients.

E. Credit Union Funding

A particular issue with regard to flexible funding involves credit unions and other savings-based institutions. Within the microfinance profession there are differences of opinion about the appropriateness of providing loan capital to savings-based MFIs. One view, probably the dominant opinion among credit union analysts and microfinance experts, is based on repeated experiences across the world where credit union ability to grow through savings was destroyed by receipt of donor loan capital, which undermined incentives to raise deposits. Clients of such credit unions only saved the minimum amounts necessary to qualify for loans. In this view it is not appropriate to give grants or loans for capital or basic operational support to credit unions. The other view (held, for example, by TSP Socodevi) is that credit union growth based on savings alone is too slow, and that if credit unions are not too large and are properly managed, they can use donor funds safely to boost their ability to earn income and build equity. This evaluation is not the place for an elaboration of this debate. Rather we merely point out that MicroStart should not fund loan capital grants to credit unions until SUM has investigated this issue -- from both sides and with a look at experience -- and come to some well-founded conclusions, so that it can provide sound advice on this topic to the country offices.

F. Funding Recommendations

- Structure funding agreements to encourage MFI responsibility for performance and to enhance technical service relationships
- SUM should develop a format based on objective targets and clearly stated procedures for withholding tranches
- SUM should develop guidance and supportive information to help MFIs plan long run funding strategies that involve donor independence
- Allow flexibility in the amount and timing of MicroStart funds
- Refrain from providing grants to credit unions and other savings-based organizations until SUM has considered the issue carefully and come to a policy position.

Can MicroStart Have a Significant Impact on Policy and the Environment for Microfinance?

MicroStart programs establish an action-oriented framework for bringing key players together to learn about microfinance development. These players include government policy makers, private sector actors (potential social entrepreneurs or financiers), MFIs, and other donors. By creating this interaction, MicroStart has the potential for significant influence on the thinking of policy makers and other leaders. This potential was clearly demonstrated in Morocco, and to some extent Ivory Coast. At times, the effort of bringing all the players together causes frustrations and delays. However, the effort is worthwhile because bringing all these pieces together is what makes MicroStart especially effective in influencing the environment for microfinance.

A. Advisory Boards and Government Policy Makers

The evaluation showed that MicroStart has a significant impact in the two countries visited where microfinance is new. In Morocco and Ivory Coast the advisory boards include people who, by virtue of their positions in the government, the private sector and the donor community, are in a position to influence the evolution of the microfinance industry. The concentration of opinion leaders in one committee has allowed them to combine and concentrate efforts that have added up to more than each individual could have accomplished alone. MicroStart has also:

- Enabled wide access to and efficient dissemination of accurate information on microfinance
- Organized discussions and debates in a forum that has a purpose and a decision-making role specific to microfinance
- Brought influential leaders together in one cohesive entity

The advisory boards take their responsibilities towards MicroStart seriously. They consider carefully which MFIs are performing, which are not and what to do about it. They listen closely to and learn from the TSP's knowledge and experience. The success of the advisory board relates directly to how it is constituted. It is crucial that the right people are on the board, particularly the key people charged with overseeing microfinance within government, some people with a strong business orientation, and some who are microfinance experts. The board training that SUM conducts at the launching of MicroStart in some countries appears to have a positive effect on the quality and performance of the advisory board.

In addition, the UNDP government-executing agency is involved in MicroStart. In Ivory Coast and Morocco, the combined involvement of the executing agency and the leaders on the advisory board has had significant impact on the legal framework regulating MFIs. In Morocco, the government had already begun the process of developing a law on microcredit when MicroStart began, and the basic elements of the law had been sketched out. But MicroStart has been a learning laboratory for the regulators of microfinance, a first chance to become involved deeply with the practical issues. Through MicroStart, key officials have had ample chance to see how organizations actually operate and debate best practice concepts such as interest

rates and financial viability. The Ministry of Finance representative who sits on the advisory board is responsible for regulating specialized financial institutions. He and his office now understand the need for cost-recovery interest rates, and although it must bow to the Islamic disapproval of high rates, his office will leave the door open for organizations to charge additional fees.

In Ivory Coast, the government-executing agency chosen by UNDP for MicroStart, IMEC, is responsible for overseeing application of the PARMEC law which governs MFIs. The IMEC representative is a member of the advisory board and he has convinced the board that all MFIs participating in MicroStart must be either registered under PARMEC or in the process of doing so.

In Mongolia, the TSP and the newly-created MFI, XAC, have worked with the Central Bank to develop an appropriate institutional framework for a microfinance institution and regulations on the supervision of and accounting standards for non-bank financial institutions.

In the Philippines, on the other hand, MicroStart is one of many microfinance programs and its advisory board one of too many committees. In this setting, MicroStart is not likely to have much policy influence. This suggests that MicroStart will have more influence in countries where microfinance is still a fairly new phenomenon.

In fact, MicroStart has a unique role in countries new to microfinance, because of the way that it organizes the players around the introduction of best practices. In countries with established microfinance sectors, MicroStart should enter only when it can identify a specific value added from its presence, for example, as in Zimbabwe where it is bringing in new kinds of organizations.

B. MicroStart and Government Funding Apexes

In the Philippines, Egypt and Zimbabwe, the government executing agency provides wholesale loans to MFIs to capitalize their lending operations. In essence, they are funding apexes. In such cases, loans—not grants—are given to MicroStart participants. In Zimbabwe and Egypt MicroStart is dealing with standard social funds developed to mitigate the effects of structural adjustment. Such funds typically have a large pool of resources, but they have a history of supporting microfinance as a charity or providing loans directly themselves, in classic bad-practice fashion. In Egypt, for example, loans are structured in a way that precludes the MFI from operating sustainably. MicroStart is helping these funds develop more appropriate ways of working with microfinance. In the Philippines, the apex already has a large portfolio of loans to MFIs which are based on reasonably sound selection criteria and policies. However, the procedures of the facility are very cumbersome, and they cause problems for the MFIs participating in MicroStart.

The practices followed by such government apexes leave much to be desired. Procedures are complicated and the process takes too long and is frustrating to the MFIs. MicroStart, however, puts UNDP and opinion leaders involved with microfinance in a position to influence government agencies to adopt better practices. MicroStart should not become a promoter of government apexes as a general strategy. However, in cases where such apexes exist, and where government has directed those apexes to take the lead in microfinance, it makes sense for MicroStart to work with apexes, in part to engage in dialogue about improving apex operations.

But what are those better practices? And who knows about them? In order to wield its potential influence effectively, UNDP—perhaps through its MicroStart advisory board—needs to develop expertise in the area of sound practices of a government-funding apex. Furthermore, a strategy is needed on how the expertise will be gained, and how to persuade governments to adopt better practices.

C. Influence on Donor Policy

MicroStart's mechanism of talking through funding proposals with advisory boards is an improvement over the standard donor model of just funding a single organization -- because it means lessons from the experiences are learned widely. With a MicroStart program in place, it will be more difficult for a donor to fund bad-practice, because the funding process is somewhat more open. The one-on-one model, on the other hand, keeps the lessons inside. MicroStart should be an attractive mechanism for other donors to support for that reason. This goes for UNDP offices as well. MicroStart operates side by side in some countries with egregious examples of bad practice in UNDP portfolios, such as having UNVs make loans directly. SUM should consider whether it can use MicroStart to raise questions about such practices.

D. Recommendations

MicroStart should continue the advisory committee process, particularly with the new training program. We have only a few recommendations to improve the policy impact of MicroStart:

- Focus on countries new to microfinance. In other countries, search for value added
- Add best practices for government apex funders to SUM's learning agenda.
- Strengthen efforts to influence UNDP policy (see below)

Is MicroStart a Successful Microfinance Strategy for UNDP?

When MicroStart began, its designers were attempting to develop a program that would fit well with UNDP's strengths and weaknesses. They decided to focus on new institutions, recognizing UNDP's presence in many countries where microfinance was still new, as well as the limits on UNDP's ability to provide grants. In order to compensate for the lack of experience of country office staff, they developed a project blueprint that they hoped would prevent some of the most likely errors UNDP offices with little microfinance background might make.

These were good choices. The focus on young organizations in new countries fills a niche that other donors have neglected. Some of the major donors who promote microfinance have chosen to support institutions who already have a proven track record and established client base. Other donors prefer to fully fund and provide technical assistance to an institution they fund from scratch. There is virtually no significant or systematic support for institutions that are "home grown" or young and/or small. This is particularly true in countries new to microfinance. Providing technical assistance via an international technical service provider and a small grant for operating losses and loan capital is an important market niche in such countries. In countries where microfinance is fairly well developed however, MicroStart will have to identify its niche and value-added differently. For example, in the Philippines its main contribution may be in introducing ASA's efficient operating systems.

As for the original blueprint, it was a good way to start, but, as this evaluation has showed, MicroStart is already beginning to outgrow it. Ultimately, SUM must rely on the decision-making capacity of the country offices, simply because of their day-to-day presence. In recognition of the need to allow greater country-level decision making, SUM has already taken steps to increase MicroStart's flexibility.

A. UNDP Country Offices

UNDP country office staff have, by and large, proven themselves capable of managing MicroStart.

Country office staff are especially important for coordinating the various levels of players involved in MicroStart. They have played an important role in ensuring that relationships work and the process moves ahead smoothly. It is doubtful that advisory boards, TSPs, and the executing agencies would have been able to achieve positive outcomes without the significant coordinating efforts by UNDP country office focal points.

Generating a feeling of ownership towards MicroStart is a very important consideration. Facilitating ownership at all levels is something that SUM sees as crucial. In the countries visited, SUM appears to have been successful in this endeavor. Perhaps the most important contribution has been in SUM's effort to build the capacity of the country office focal person and of the advisory board. Access to capacity building opportunities has been crucial to instilling confidence and generating ownership. Examples of important activities are the various study tours and participation in the Boulder, Colorado courses on microfinance. Increased knowledge and experience enhances ability to make sound decisions. However, this only happens with time, while the most important decision affecting the success of MicroStart happen at the beginning (choice of TSP and MFIs) before the country office and the advisory board have

gained sufficient capacity. For this reason, SUM's new capacity building program will be very important.

For the successful oversight of a MicroStart program, the country office should identify a staff person with time to focus on MicroStart. It appears to require a minimum of half time during the planning stage and first few months of implementation, and quarter time thereafter. It is also important that the country office recognizes the need for the TSP to have freedom to make technical judgments -- particularly on MFI and LTSP selection.

Country Offices (especially Resident Representatives) are interested in the bigger picture of their overall UNDP strategy as it relates to the country, particularly as it relates to poverty issues. The information and guidance SUM provides on the role of microfinance in poverty alleviation is especially valuable.

B. The Role of SUM

Like a parent raising children, as MicroStart matures, SUM's role evolves with the increasing capacity of the country offices. At first, SUM was the developer, promoter, and arbiter of MicroStart. Increasingly, however, SUM can evolve into a longer term role as service provider and center of technical expertise. SUM has already done some important things to improve the operation of MicroStart:

- Increased flexibility
- Identified key areas for SUM intervention
- Launched new capacity building program
- Identified desire to build learning agenda about how to support local organizations (see box).

As a service provider, SUM's focus should be on getting its staff into countries developing MicroStart more often, being responsive to needs from the field as they arrive, developing guidance on critical issues (see next section for suggestions) and providing opportunities for exchange of experience among country offices and among TSPs.

As a technical office, SUM's plate is more than full with the capacity building initiative for country offices, the learning agenda, and its information dissemination function.

In the recent stringent budget setting facing UNDP, SUM may also need to

A Learning Agenda for SUM/Microstart

SUM has noted that it wishes to be a center for learning about how to support young MFIs. Here are some suggested topics, it may wish to explore, using the Microstart programs as a learning laboratory:

- Getting the right people into microfinance. Who starts MFIs? Who should start them? How?
- Analysis of the origins and early stages of highly successful MFIs: what are common characteristics of breakthroughs?
- What makes technical assistance relationships work? Analysis of various models and of TSP performance.
- MIS systems for young MFIs. Is a paper-based system like ASA's the best route for a very new organization? What computerized products are suitable for very small organizations?
- Credit unions: should they receive grants?
- Best practices and internal procedures for Government financing apexes.

These are in addition to themes SUM has already identified, including impact and gender.

take on a larger role in raising funds through other donors.

C. Recommendations

SUM should plan for greater autonomy for MicroStart at the country office level, through the dual strategy of capacity building and of SUM input at fewer, but more critical points in the process.

VI. Points of Intervention

This section is a walk through the MicroStart process, with specific recommendations. It focuses on the key areas of intervention SUM has identified. SUM's goal is to develop simple, efficient, and meaningful procedures, and these suggestions are offered in that spirit.

A. Assessment Stage

SUM has treated the assessments as a relatively routine part of the process, seeing them as ways to get the process moving rather than important in themselves. This has been good for developing local ownership, but has done little to help identify good MicroStart strategy. At this point, when the rate of new assessments has slowed, SUM can afford to put more time of its own staff into each one.

Goals of the assessment stage:

- Developing ownership of the process on the part of the UNDP country office
- Identifying options for MicroStart's potential value added, as basis for designing strategy (and prodoc)

The consultants carrying out the assessments have been asked to describe the microfinance scene and to determine whether there are enough institutions to make MicroStart worthwhile (and by implication to name some of them). Instead, they should be asked to look at major trends taking place in microfinance. In particular, they should try to figure out who the major providers of microfinance services are likely to be in the next five years, and which clients they will -- and won't -- be serving. Within that context they should then identify ways MicroStart could add significant value. This will enable everyone involved to start thinking earlier about making breakthroughs. At this stage, SUM should also assess whether the country office has allotted sufficient staff time and expertise to manage the MicroStart process. The assessment may also be a good opportunity to review existing UNDP microfinance activities, to begin a dialogue about changing bad practices within that portfolio.

B. TSP Selection and Agreements

SUM has recently revised the format for its request for proposals in a way that takes care of most of the issues raised about TSP selection during the evaluation. The new format focuses more attention on the content and delivery methods the TSP proposes to use. Other points about SUM involvement in TSP selection and about updating the TSP list were discussed above.

One area for further work involves the agreements signed between UNDP and the TSPs. The aim of that work should be to sharpen and clarify the targets for which TSPs are responsible. SUM has tried to implement performance-based contracting, but has ended up with a hybrid that includes elements from old systems as well as new ones. Existing agreements refer to the Program Document, the TSPs own proposal, and workplans, each containing various ways of describing desired targets (i.e. different mixes of indicators) and end of project status. The

numbers contained in the targets also differ, as these are continually refined, remaining tentative until the MFIs have been selected and their individual workplans established.

The agreements should be simplified. They should point to one clear source for guidance on operable targets, preferably those contained in the workplan, because those targets are more up to date and reflect the actual project situation, rather than the early attempts at estimation involved in the assessment and the TSP's initial proposal (which are based on very sketchy information). Currently, targets are being set too low, because TSPs want to be conservative, especially in the early stages before they have had a chance to assess the MFIs.

UNDP Country Offices and contracting authorities should not be overly concerned about signing a \$500,000 results-based contract without clear results specified in the contract at the moment of signature. The contract clearly state the process for identifying those results, and states that they will be attached to this contract when they are locally approved. The desire to have some interim targets specified (from the Program Document, and the TSP proposal) until the TSP workplan is approved brings in the greater risk that these multiple targets will confuse and undermine a clear focus on the TSP workplan. The existing standard contract should be simplified by referring only to the TSP workplan. Since the risk to UNDP remains only \$50,000, while the TSP prepares its workplan, this is an acceptable risk.”

Targets for TSPs should include both the combined or, where appropriate, averaged performance targets of the MFIs (see below), and some output targets for delivery of technical assistance.

C. MFI Selection and Agreements

1. Selection

MFI selection is the single most important step in the MicroStart process. It determines whether MicroStart will be able to assist breakthroughs or only incrementalists. SUM has a very strong stake in ensuring that it is done well. This will require greater SUM involvement, though it must be done carefully so as not to detract from local ownership.

One straightforward step is to amend the guidance and training for TSPs and advisory boards on MFI selection to emphasize how to identify organizations with breakthrough potential. The message should pervade everything MicroStart says or writes. SUM may wish to provide a sample format for reporting the results of the assessment of each MFI. That format could have both numerical indicators and qualitative assessments of leadership and potential.

SUM should find a way to be more involved in reviewing the work of MFI selection. This may be a review of the proposed MFIs and workplans (as SUM is now doing for Haiti). It could be ensuring that a SUM staff member is present at the advisory board meetings where selection is done or in the lead-up to those meetings. Whatever the mechanism chosen, SUM's main role would be to urge that low potential organizations are screened out and high potential organizations are screened in.

2. Agreements

SUM should also develop a sample format for agreements with MFIs, as described above. The format should include the key targets that the MFI will be held responsible to reach. The following are suggested:

- Number of active clients
- PAR-30 (Portfolio at risk over 30 days)
- Operational self-sufficiency

These three indicators embody the major goals MicroStart would wish to see: growth in outreach, control of delinquency (which also reveals client responsiveness and institutional competence), efficiency, and appropriate pricing. If there is an issue about client targeting with a particular MFI, an average loan size or percent women target could be added. However, for the most part, other targets would be superfluous and repetitive.

One section of the agreement should lay out clearly the terms under which successive funding tranches would be withheld or postponed. Those terms should be limited to the achievement of the targets, plus the provision of accurate reporting suitable for verifying whether targets are achieved (TSP to verify accuracy). They should not include acceptance or rejection of specific institutional suggestions by the TSP. One technique for ensuring that targets are set ambitiously but realistically is to set out preferred targets, but also to specify minimum acceptable levels of performance, below which funding could be suspended, say at 70 percent of the target.

As noted in the section on funding, it is important for the lines of responsibility between funder and MFI to be strengthened, rather than mediated by the TSP. For that reason, every effort should be made for the targets to be proposed by the MFI itself.

The workplans for technical assistance and institutional development are important as part of the overall package, but they should be seen as agreements mainly between the TSP and the MFI. The workplan is in effect a business plan, guiding the direction of and prioritizing technical assistance. The MFI should be charged by the funder to participate actively in the technical assistance being provided, with the proviso that the TSP can ask the advisory board for permission to drop the MFI from the TA portion of the program if it feels that the MFI is not cooperative (or vice versa -- the MFI can petition for withdrawal).

D. Implementation Stage

1. Monitoring and Reporting

SUM has developed an excellent system for monitoring and reporting, where information is available to all country offices involved in MicroStart through a web page. This system is focused around quarterly reports, which include a series of indicators of MFI performance. Nevertheless, a few improvements could be made.

The most important of these is to include reporting on operational self-sufficiency in the quarterly reports. Currently financial performance information is only requested annually. Managers of MFIs should be looking at such information more often, however. Moreover, given

that the focus of the reporting system is the quarterly report, not annual reports, it would be more effective for monitoring purposes to include the information there. Most importantly, exclusion of financial performance indicators from the key reporting document sends a signal that sustainability is not a core concern of MicroStart, or is something MFIs can look at later on.

SUM should use these monitoring reports to identify areas of weakness in the overall program. The quality of the data in the current system is not as high as it should be -- for example, data from one institution being repeated on the line for a different institution; confusion about the interpretation of delinquency numbers, and missing data. These are not surprising problems. SUM is to be commended for getting as much cooperation in reporting as it has!

2. Timely Disbursement of Payments

Problems have appeared throughout the MicroStart system regarding timely payments, to both TSPs and to MFIs. It should go without saying that payment delays can seriously hamper the project's functioning. Most of the TSPs have shallow pockets, particularly when it comes to unrestricted funding, and they should not be expected to provide bridge financing to cover bureaucratic problems. Even more important, many of the MFIs have few alternative funding sources, and depend on the MicroStart funds to be able to meet basic goals. At best, payment delays bring a loss of good will. At worst, they cripple program implementation. The evaluators did not investigate the causes of late payments in detail, but identified enough examples to conclude that this matter needs serious attention if it is not to reduce the future success of MicroStart.

3. Audit

Although MicroStart has a requirement that the participating MFIs should be audited, the only audit we were aware of was performed by the national government's inspector general, and therefore was not the kind of audit relevant for microfinance. SUM may wish to examine this issue more closely, to see whether it can provide guidance to country offices on how to arrange for more worthwhile audits.

E. Completion and Renewal Stage

Three years is not a long time to establish the kind of institutional development MicroStart wishes to see. Even the breakthrough organizations it identifies will be far from stable and consolidated at the end of three years. Moreover, as noted above, MicroStart should become more focused on winnowing out the non-performers and offering more support to the institutions that are performing well. These reflections lead to the following suggestions about MicroStart after the first three years:

- After the completion of the initial three years, MicroStart could be renewed for an additional one to three years, to focus only on those institutions that are looking like breakthroughs. One or two new organizations could be added at this stage, with the idea of supporting a second generation of organizations, which are often founded on a stronger basis than the first generation. Support to breakthrough organizations

might not follow the standard TSP format, but could be more specifically tailored to those MFIs.

- For new MicroStart programs, mechanisms could be evolved to begin the winnowing process earlier.
- Meanwhile, SUM needs to address existing confusion about expiry dates of the various contracts it now has in place. The standard problem is that the contracts with TSPs last for three years, as do the agreements with MFIs, but because the agreements with MFIs are generally signed some time into the process, especially for MFIs picked up in a second round, there is a question about how or whether to make the end dates for assistance coincide.