

SDC Letter to Management

Executive Summary

A team comprising Dirk Steinwand from GTZ, Johan de Waard, Ministry of Foreign Affairs, the Netherlands, and Brigit Helms and Eric Duflos of CGAP conducted a Donor Peer Review of SDC in Bern from 18 to 22 August, 2003. The review is part of a 17-agency initiative launched by Development Ministers, heads of agencies, and CGAP to concretely tackle aid effectiveness by using microfinance as a test case.

The Peer Review team focused on the internal procedures, practices and processes of SDC to identify the success factors and constraints that influence the effectiveness of the agency's microfinance operations. The Financial Sector Development (FSD) staff provided the team with an orientation to SDC and organized meetings with 54 people throughout the agency, including consultation with country departments, cooperation office staff and external partners. The team briefed Managing Director Ambassador Walter Fust and staff on its initial findings on 22 August 2003.

The team hopes that this letter to management will enrich the internal discussions and provide ideas on how SDC can further increase its effectiveness in microfinance. This letter outlines SDC's strengths and challenges, and presents specific recommendations. A matrix at the end of the letter provides a summary of the key findings and recommendations.

The peer review team makes five concrete recommendations to management to enable SDC to improve its microfinance operations. The team hopes these recommendations will also prove helpful for enhancing SDC's overall effectiveness.

1. ***Sharpen strategic clarity on Financial Sector Development (FSD).*** SDC should build ownership for its existing FSD policy by illustrating its operational implications with regional good practices while involving top management.
2. ***Improve quality and accountability of operations.*** SDC needs to improve the quality of its operations by ensuring that any project with financial services (e.g. funds) receives systematic technical inputs at the planning stage. In addition to spelling out clear exit criteria, SDC should also increase accountability for results by applying performance based contracts and stronger monitoring systems.
3. ***Enhance technical capacity.*** SDC should build technical competencies within the rotation framework, maintain minimum technical expertise for program management and further define the role of the FSD team.
4. ***Deepen knowledge management.*** SDC should create incentives and promote mutual benefits for knowledge management, develop professional networks, and design instruments to disseminate know how among cooperation offices, the rest of the organization and other agencies.
5. ***Increase partnership with SECO and other agencies.*** SDC should continue to build on its partnership with SECO, promote itself as a flexible partner to other donors and continue to feed its field experience into policy dialogue.

Background

Early in 2002, Development Ministers, heads of agencies, and CGAP launched an initiative to improve aid effectiveness, using microfinance as a test case. As a first step, 17 bilateral and multilateral development assistance agencies volunteered to participate in a series of Donor Peer Reviews. These Peer Reviews are not evaluations or detailed portfolio reviews, but rather focus on each agency's internal procedures, processes, practices and systems to identify success factors and constraints to good practices in microfinance.

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

A Peer Review team including Dirk Steinwand, Head of the Financial System Development Section from Gesellschaft für Technische Zusammenarbeit (GTZ), Johan de Waard, Financial Sector Specialist from the Netherlands, and Brigit Helms, Lead Microfinance Specialist and Eric Duflos, Microfinance Specialist of the Consultative Group to Assist the Poor (CGAP) visited the Swiss Agency for Development and Cooperation (SDC) headquarters from 18 to 22 August, 2003. The peer review team interviewed 54 people from a wide range of divisions (Management, Asia I, Asia II, Eastern and South Africa, West Africa, Latin America, Service NGO, Social Development, Employment and Income, CIS, Special and Regional Programmes, South Eastern Europe, Humanitarian Aid), Cooperation Offices, and many SDC partners (SECO, Swisscontact, NGOs and consultants). The team presented its initial findings and recommendations to Ambassador Walter Fust, Managing Director of SDC, and several staff on 22 August.

Follow-up to the Peer Reviews is envisioned both at the agency-specific level and across all agencies participating in the exercise. The review team and CGAP are available to discuss the recommendations contained in this letter in more detail and to support their implementation. The team's findings for SDC will also be combined with those from other agencies reviewed in a synthesis report. A synthesis report already exists for agencies reviewed in 2002. Overall results and issues for agencies to tackle jointly will be discussed in various fora involving technical staff and senior management. A meeting of Ministers and agency heads participating in the Peer Reviews will be organized upon completion of all the reviews on 13 February 2004 in Paris to share experiences and reforms made as a result of the exercise and to build on agencies' comparative advantages.

This letter to management outlines SDC's strengths and challenges with respect to applying good practices in microfinance. It then presents a number of specific recommendations for change. Finally, a matrix summarizes the key findings and recommendations according to six analytical areas. The team hopes these recommendations will also prove helpful for enhancing SDC's overall effectiveness.

SDC: a mirror of Swiss Culture

It is impossible to analyze SDC's effectiveness in financial sector development or microfinance without understanding its organizational culture. SDC culture mirrors Swiss culture, with an identity that is much stronger than is found in other agencies. Some key characteristics include: high value on autonomy and independence, a pragmatic and flexible approach to development, decentralized decision making, willingness to take risks and innovate, and a strong sense of "being different" from the rest of the world.

This organizational culture has a number of implications for SDC's development work. There are many different cultures within SDC. It means that the local context is valued above all else, and that personal networks and innovations are preferred over formal structures and standard procedures. This culture however makes it challenging to apply strategies and promote standards uniformly within the agency.

SDC trends

In addition to SDC's culture, there are certain trends that are emerging in the organization that influence the *modus operandi* of the organization. These trends are of major concern to staff and affect the way they work.

<i>Then...</i>		<i>Now...</i>
· Focus	➔	· Proliferation
· Sectors	➔	· Themes
· Specialists	➔	· Generalists
· Stability	➔	· Rotation
· National	➔	· International
· Own projects	➔	· Mandates
· Inward looking	➔	· Open

- While SDC used to focus on a limited number of technical competencies in the past, it has increased its areas of intervention to a point that several staff interpret as a proliferation of topics.
- The organization used to function with sectors whereas it is now adopting broader themes that can incorporate several sectors.
- The human resource profile is changing from one of specialists in traditional sectors like agriculture and engineering to one of generalists, and staff are expected to rotate more often than in the past.
- From a relatively inward looking organization, SDC is opening itself up to the outside world. This change reflects the thrust of Switzerland to become more outward looking as illustrated by its recent joining of the United Nations. This trend has significant implications for how SDC launches new initiatives, increasingly in cooperation with other agencies and delegated to mandated organizations.

SDC Strengths

Based on its understanding of SDC's culture and recent trend, the peer review team has identified the following strengths which have a direct influence on the effectiveness of SDC in microfinance:

- **SDC Financial Sector Development policy reflects good practices.** SDC was ahead of its time with its FSD policy, developed in 1998, that still remains valid today. The policy considers financial services for SDC's target groups as part of the financial sector, underlines the importance of sustainability, and identifies the SDC niche at the institutional level. It represents one of the best examples of financial sector strategies among the various agencies participating in the peer reviews.
- **SDC balances social and economic objectives.** By combining an economic demand-based approach with a concern for reaching and empowering their target groups, SDC strikes a good balance between social and economic objectives.
- **Apparent commitment to good practice in FSD projects operations.** The peer review team has the impression that projects conceived as FSD or microfinance projects follow good practices. For example, these projects tend to focus specifically on building institutions, employ a demand driven approach, through limited disbursement pressure, and promote innovation.
- **Recent efforts to conduct portfolio reviews.** Together with cooperation offices, the FSD team has recently begun cataloguing its operations in the area of financial services for the poor. While still a draft, this initiative will provide a benchmark on the size and quality of the portfolio. Improved knowledge of the portfolio will enable SDC to identify lessons learned.
- **Some staff expertise in microfinance.** There are people with expertise throughout SDC, both in Bern and in the cooperation offices. National Program Officers (NPOs), based on interviews by the Peer Review Team, are the main assets on whom SDC can capitalize for exchanging operational knowledge at the regional level. Experience with the first sixteen agencies reviewed has shown a close relation between the level of technical expertise and the quality of microfinance operations.
- **Value of training and HRD.** SDC is fully committed to building knowledge among staff. For example, staff can invest 10 days of training per year.
- **Individual initiatives to build expertise.** While SDC has a generalist structure, some staff have succeeded in building expertise in a specific area, and there seems to be a demand for this expertise from operational departments and cooperation offices.
- **Experience in technical networks and dissemination of good practices.** Bern-based knowledge networks (such as the Financial Services Team and the Savings and Credit Forum) enable SDC to disseminate and retain knowledge within the organization, as well as exchange experiences. While the networks are mostly active at head office, there is a precedent of a regional knowledge network in South Asia.
- **Some dissemination of good practices.** Based on the experience of Latin America, the FSD team has compiled a document called "11 reasons to avoid revolving funds". It has also created guidelines on savings. Gathering and packaging internal and external knowledge is key to improving the quality of operations.

- **Increased cooperation with SECO and other partners.** Over the past few years, and especially in the Eastern Europe region, SDC has developed closer relations with SECO, which also works in the financial sector with complementary instruments such as equity. This cooperation has taken place through the creation of common field offices and joint country programs. SDC is also increasing its cooperation with non-Swiss agencies such as the UN and the World Bank.

SDC Challenges

Notwithstanding its strengths in microfinance, SDC faces some challenges that affect the effectiveness of its microfinance operations.

- **Lack of familiarity and ownership of the FSD Policy.** SDC staff have not internalized the existing FSD policy, even in those cases where they have read it. Some staff consider financial services, especially credit, as a necessary input to accomplish other objectives, especially employment and income. This perspective does not reflect the importance of building financial systems that work for the poor as laid out in the FSD policy.
- **The policy is too abstract** for day-to-day operations. It does not provide enough orientation for operational staff and coordination offices to know what to do on the ground, in their specific contexts. This lack of operational relevance might explain why the policy is not used so often by staff.
- **Limited knowledge of the portfolio.** SDC knowledge management literature states that « Knowledge is the most important capital ». While the recent review and the collection of data for the CGAP data base by the FSD team show positive trends towards knowing the microfinance portfolio better, its results do not cover the full extent and quality of the portfolio. Without overview of the content and quality of the portfolio, it is impossible to become more effective and learn.
- **Hidden rotating funds.** Rotating funds usually take the form of small credit lines integrated in non-financial development projects. Awareness on the risks presented by these components has increased in some of the geographical regions such as Latin America, but credit components are still present in several countries and within NGOs programs funded by SDC. These rotating funds do not typically receive specialist technical attention and can have negative effects on the market and on clients themselves. With the introduction of the more complex “themes”, there’s a danger of a renaissance of such rotating funds.
- **No systematic technical involvement at any stage of project cycle.** The involvement of technical expertise in the project cycle depends on personal networks, as there is no system requiring the FSD team to be involved systematically at any stage. This lack of technical involvement means that head office does not have an overview of the performance of the portfolio, preventing SDC from ensuring quality for current and future operations in microfinance.

- **Insufficient focus on results and impact.** Cooperation offices approach monitoring in different ways, some focusing on activity-based monitoring and some on performance. Limited systematic emphasis on results and impact and uneven monitoring prevents SDC from appreciating the impact of its investments, both in terms of effectiveness and in comparison with other agencies.
- **Lack of exit strategies.** Projects that include financial services do not appear to have criteria for exit. Microfinance and financial sector development aim at building markets which work for the poor. The lack of exit strategy prevents SDC from knowing when to withdraw its support, posing issues of ownership of funds and governance at the end of a project.
- **Limited incentives to build expertise.** In a generalist structure, there are limited incentives to build expertise as career paths are designed for generalists. The rotation policy does not ensure that the staff who have built specific expertise can use it in their next position. This lack of strategic rotation makes it difficult for SDC to build in its internal know-how.
- **Thin capacity and unclear role of the FSD team.** On paper, the FSD team has too many tasks compared with its human and financial resources (one person and fifty percent time of another). Most staff interviewed were not clear on the role of the FSD team. In addition to its limited resources, the team does not have the mandate necessary to play a systematic role in providing advice to projects that involve financial services.
- **False assumption that outsourcing can replace internal expertise.** Whether SDC uses its own or mandated technical expertise, a baseline level of technical knowledge is necessary for head office and cooperation office staff. Currently, staff don't have the baseline technical knowledge to engage with increasingly qualified partners.
- **Unclear roles, incentives and instruments for knowledge management.** Knowledge management is part of head office technical staff's responsibilities but the technical departments cannot engage unilaterally in knowledge management. It is not clear whether it is included in operational or cooperation office staff TORs and performance criteria. This lack of clear roles and incentives prevents SDC staff from learning from its successes and failures and from tying future operations to experience. There are not enough instruments for efficient capitalization and exchange of experiences, but rather isolated cases of lessons learnt and knowledge exchange. A significant amount of individual learning does not translate into institutional learning.
- **Knowledge management is head office based.** The fact that knowledge is mainly shared at head office does not enable SDC to integrate the experience of the cooperation offices, and to use it where the operations actually take place.
- **Limited cooperation between SDC and SECO.** Both SDC and SECO invest in the development of the private and the financial sector. While SDC has significant experience in microfinance, SECO has focused its operations on SME finance. SDC and SECO have complementary objectives and instruments. While cooperation has improved, especially in Eastern Europe, more systematic seems limited between the two agencies. By not working together on a more systematic basis, Swiss cooperation misses an opportunity to work on the development of the financial sector.

Recommendations

Based on its analysis, the peer review team makes the following five recommendations to management:

1. ***Sharpen strategic clarity on Financial Sector Development (FSD).*** SDC should build ownership for its existing FSD policy by illustrating its operational implications with regional good practices and by involving top management.
 - **Illustrate the operational implications of the policy.** To ensure that the policy is transformed into reality in SDC's operations, geographical divisions, supported by the FSD team, should develop brief «What works in country X». The geographical divisions should initiate the process, to ensure that it is deeply rooted in operations from the beginning, and then circulate their briefs together with the FSD policy within and outside their own divisions.
 - Once the briefs have been completed, SDC's Director-General should help build ownership of the policy within management. A **meeting of senior management** (possibly Costra plus all the geographical divisions) could be organised to present the main implications of the FSD policy for SDC in different contexts and its linkages with other areas of development such as employment creation, education, health etc.
2. ***Improve quality and accountability of operations.*** SDC needs to improve the quality of its operations by ensuring that any project with financial services (e.g. funds) receives systematic technical inputs at the planning stage. In addition to spelling out clear exit criteria, SDC should also increase accountability for results by applying performance based contracts and stronger monitoring systems.
 - Considering the significant danger presented by hidden credit components (referred to as rotating funds, funds, credit lines etc), SDC management should **mandate the FSD** team to provide technical resources, internally or through short-listed consultants, at the planning stage of every project that includes credit. Management should also oversee that geographical divisions call upon the FSD team to take part in the planning stage.
 - To enhance accountability for results, SDC should **apply performance based agreements** with local partners and régisseurs (executing agencies). Such contracts would link disbursement with actual results, based on agreed indicators. SDC projects need to **systematically build exit criteria** at the design stage. These agreements would include exit criteria on a systematic basis. These criteria would determine the conditions for SDC to withdraw its support. Both performance targets and exit criteria should be developed at the design stage.
 - SDC should also **strengthen performance monitoring** based on its existing systems. With support from other donors and existing literature, the FSD team could draft a one page list of indicators that need to be monitored in the field on a regular basis. SDC could also require its partner financial institutions to report to the Microfinance Information eXchange (MIX). (www.themix.org). The system should be kept simple.

3. **Enhance technical capacity.** SDC should build technical competencies within the rotation framework, maintain minimum technical expertise for program management and define further the role of the FSD team.

- SDC should **build technical competencies within the rotation framework.** To ensure that SDC staff can build a career around a specific development sector, management should create a strategic rotation system. Staff could then easily move to a country where their specialty is predominant so that they continue to build their own expertise.
- **Maintain minimum technical expertise for project management.** To provide appropriate technical support to operations, SDC project management staff need to acquire a basic level of knowledge in microfinance. Without becoming experts, they could take further advantage of existing training opportunities: Boulder, Bankakademie, N. Hampshire, CGAP/UNCDF. Given the high potential of the NPOs, their attendance to such training could significantly improve project management of microfinance operations.
- **Redefine the role of the FSD team.** Considering its limited resources the FSD team cannot realistically complete all the expected functions. The FSD team must clearly communicate its «offer» to the rest of the house. The peer review team recommends the FSD team to focus on the following tasks, noting that some of them are already being undertaken.
 - Knowledge management (including supporting cooperation offices to introduce performance monitoring and evaluation).
 - International liaison with other donors, CGAP, Donor Working Group
 - In-house focal point for inputs related to financial services/FSD in relation to, for instance, MDG's and PRSP process.
 - Quality assurance during key “moments forts”: country programs and sectoral strategies, concept clearance for new and cluster projects. Being involved at the early stage in a few areas of the project cycle will give the FSD team credibility and field experience to be effective. FSD’s support should be based on cooperation agreements with geographical divisions. These agreements could include drawing on external consultants.

The peer review team also believes that due to its current limited resources, the FSD team should not be involved in the following tasks, except in exceptional cases:

- Direct training.
- Annual country programs, project planning, project approval, backstopping.

4. **Deepen knowledge management.** SDC should create incentives and promote mutual benefits for knowledge management, develop professional networks, and design instruments to disseminate know-how among cooperation offices, the rest of the organization and other agencies.

- SDC management should **create incentives and promote mutual benefits** for knowledge management. Management should include knowledge management in staff TORs, and SDC's performance assessment system, and it should reward staff who excel in this area. Show case opportunities with awards for the best story could also be organized. SDC management could also send clear messages on the importance of knowledge exchange during key meetings (Costra and staff gathering).

- To increase the scope of the knowledge and connect people in their context with the rest of the world, SDC should **encourage the development of selected professional networks** and **incorporate NPOs** into these networks. Outputs of such networks could be reflected upon in regional meetings from time to time where professionals could exchange their experiences and launch joint initiatives in microfinance. A prerequisite to get the above underway is availability of sufficient resources.
 - SDC should **design instruments to disseminate knowledge** internally and externally. These instruments should enable knowledge, experience and lessons learned in the field to be integrated by headquarters and then into the planning process between cooperation offices and other agencies. They should remain lean and efficient and could be virtual (yellow pages of “who knows what”, websites, chat rooms) or physical (annual regional gathering of networks). SDC should also take opportunities of international meetings and media to further disseminate its experiences to the rest of the world.
5. ***Increase strategic partnerships with SECO and other agencies.*** SDC should continue to build on its partnership with SECO, promote itself as a flexible partner to other donors and continue to feed its field experience into policy dialogue.
- SDC could **further increase its cooperation with SECO.** Such cooperation could enable SECO and SDC to strengthen the effectiveness of Swiss cooperation. Cooperation could include staff exchanges and new co-funding modalities that could be tested in pilot countries. Both agencies should build on their complementarities of instruments. For example, SDC could make grants to MFI to develop new products and SECO would provide equity. Or each agency could offer sequential support to a financial institution at different stages of its development.
 - SDC should **promote itself as a flexible partner to other donors.** SDC has the necessary flexibility and capacity to set up operations rapidly, which most donor agencies don't have. Through donor coordination events SDC could play a significant role in complementing the operations of others in areas where flexibility and rapidity are key to success.
 - **SDC needs to remain involved in the policy dialogue through its cooperation offices.** While SDC does not have a comparative advantage in taking full leadership in the area of microfinance policies, it could contribute to the work being done by larger donors by feeding in its ground experience through enhanced in-country donor coordination.
 - **Build up linkages between cooperation offices and the Swiss banking sector.** Considering Swiss history in the banking sector with both strong cooperatives and banks, SDC head-office could help cooperation offices link up with the Swiss banking system either for technical advice or for re-financing microfinance institutions.

AID EFFECTIVENESS AND MICROFINANCE MATRIX – SDC

		Analysis	Recommendations
1.	Strategic Clarity and Organizational Culture	<ul style="list-style-type: none"> • SDC Financial Sector Development (FSD) policy reflects good practices • SDC balances social and economic objectives • Lack of familiarity and ownership of the FSD policy among staff • The policy is too abstract for day to day operations 	<ul style="list-style-type: none"> • Illustrate the operational implications of the policy with brief “what works in country X” • Organize a meeting of senior management to present the main implications of the FSD policy and its linkages with other areas of development
2.	Technical Expertise & Resources	<ul style="list-style-type: none"> • Some staff at SDC have expertise in microfinance, especially among the National Program Officers (NPOs) • No systematic technical involvement at any stage of the project cycle • Thin capacity of the FSD team and unclear role for the staff • False assumption that outsourcing expertise can replace internal expertise 	<ul style="list-style-type: none"> • Build technical competencies within the rotation framework • Maintain minimum technical expertise for project management by training staff on basic knowledge • Re-define role of the FSD team to focus its mandate on knowledge management, international liaison, quality assurance in country programs, sectoral strategies and project concept clearance
3.	Organizational Structure and Flows	<ul style="list-style-type: none"> • Recent efforts to conduct portfolio reviews but the knowledge of the portfolio is still limited • Experience in technical networks and dissemination of good practices • Increased though still insufficient cooperation with SECO and other agencies • Unclear roles, incentives and instruments for knowledge management • Knowledge management is head office based and does not integrate cooperation offices experience 	<ul style="list-style-type: none"> • Encourage the development of selected professional networks and incorporate NPOs in these networks with appropriate resources • Design instruments to disseminate know how within the agency and externally in a way that builds on the knowledge developed in the field • SDC should promote itself as a flexible partner for other donors

		Analysis	Recommendation
4.	Instruments and Incentives	<ul style="list-style-type: none"> • Commitment from SDC to building knowledge among staff • Insufficient focus on results and impact and uneven monitoring systems • Limited incentives to build expertise within a generalist structure 	<ul style="list-style-type: none"> • Create incentives and promote mutual benefits for knowledge management by rewarding staff who excel in this area
5.	Program Cycle	<ul style="list-style-type: none"> • Apparent commitment to good practice in FSD projects operations • Hidden rotating funds integrated in non-financial development projects • Lack of criteria for project exit strategies 	<ul style="list-style-type: none"> • Mandate the FSD team to provide technical resources at the earliest stages of every project that includes financial services • Apply performance based agreement with local partners and régisseurs • Systematically build exit criteria at the design stage • Strengthen performance monitoring based on existing systems by drafting and monitoring key indicators
6.	Future Microfinance Operations		<ul style="list-style-type: none"> • Further increase its cooperation with SECO • Remain involved in policy dialogue through enhanced in-country donor cooperation • Build up linkages between cooperation offices and the Swiss banking sector



The Director-General

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Ms. Brigit Helms
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January 12, 2004

Appreciation of the Donor Peer Review in the SDC

Dear Ms. Helms,

In my letter dated November 20, 2003, I informed you that the SDC will undertake an appraisal of your recommendations and draft an action plan by the end of the year 2003. Our action plan is based on the five concrete recommendations of the Review team. It builds on the SDC's continuous efforts to enhance its effectiveness and can be summarised as follows:

1. Sharpen strategic clarity on financial sector development

We will more clearly communicate the significance of pro-poor financial sectors in development (in-house and publicly), the main orientations of the SDC policy, and the Head Office's offer of support to its operational Divisions.

2. Improve the quality and accountability of operations

This is a continuous process which we will strengthen during the years to come (quality at entry of operations, monitoring and evaluation practices, portfolio information).

3. Enhance technical capacity

Our policies and systems (staff rotation, secondment, training) provide opportunities to strengthen technical capacity. Efforts will be undertaken to systematically make use of them.

4. Deepen knowledge management

SDC has specific capacities to promote knowledge management and learning. A challenge remains a better involvement of staff in partner countries for enhanced lateral and horizontal organisational learning.

5. Increase partnership with seco and other agencies

Important steps have recently been taken to make use of synergies with seco and to learn from each other. This line of action will be pursued pragmatically in future, too.

SDC is committed to building on the momentum which the Donor Peer Review on Microfinance has created. Doing so as a member of CGAP is a good opportunity. SDC considers CGAP to be



a unique mechanism to align and harmonize donors' contributions to financial sector development in developing and transition countries.

We request that you publish this letter together with the Letter to the SDC Management dated October 29, 2003.

Looking forward to meeting you and colleagues of Development Agencies soon in Paris, I remain,

Yours sincerely,

Swiss Agency for Development
and Cooperation (SDC)

Walter Fust

Copy: Elizabeth Littlefield, Managing Director CGAP, Washington