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## **Comments of the Office of Evaluation on the IFAD Rural Finance Policy**

Evaluation Committee — Fifty-fifth Session  
Rome, 8 April 2009

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For: **Review**

## **Note to Evaluation Committee members**

This document is submitted for review by the Evaluation Committee.

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## Comments of the Office of Evaluation on the IFAD Rural Finance Policy

1. **Background.** The Office of Evaluation (OE) undertook a corporate-level evaluation (CLE) of the IFAD Rural Finance Policy (RFP) in 2006, which was discussed by the Evaluation Committee at its forty-sixth session<sup>1</sup> in December 2006 and the Executive Board at its eighty-ninth session, in April 2007.<sup>2</sup> The Board took note of the overall findings and recommendations of the evaluation and endorsed the evaluation's Agreement at Completion Point (ACP).<sup>3</sup>
2. In light of the aforementioned and in line with the provisions contained in the Terms of Reference and rules of procedure of the Evaluation Committee<sup>4</sup>, the Committee, in approving the provisional agenda for 2009 at its fifty-fourth session, agreed to discuss the new IFAD Rural Finance Policy together with OE's comments, before the policy is presented for Executive Board approval in April 2009.
3. **General comments.** This new policy, formulated through a broad participatory process, is a positive development for one of IFAD's priority sectors: rural finance currently represents around 20 per cent of IFAD's investment portfolio. The development of the new policy is consistent with the recommendation of the above-mentioned evaluation.<sup>5</sup> Management's work in enhancing IFAD's decision tools for rural finance will also be useful in the implementation of the new policy.
4. An earlier internal draft of the policy benefited from OE comments solicited by Management. The present comments refer to the final document to be shared with the Evaluation Committee and the Executive Board. The positive process followed in developing the policy reflects the importance of constructive engagement between OE and Management, especially in those cases for which an ACP or existing independent evaluative evidence is on record.
1. The new policy is clearly a step forward for IFAD as compared with the previous policy and will serve as a useful reference tool for staff and others concerned with the design and implementation of rural finance projects and programmes. Section II on *Defining Rural Finance* is highly relevant, as it clarifies the various terms (such as rural finance, microcredit, microfinance, financial service providers, etc.) at the foundation of the policy and IFAD's work in the sector.
5. The policy also clarifies corporate rural finance objectives, standards and supporting instruments. It specifies the three different levels of focus for IFAD's future efforts to promote inclusive rural financial services: (i) micro level – financial service providers and final beneficiaries; (ii) meso level – financial infrastructure, specifically second-tier organizations and apex institutions; and (iii) macro level, covering policy and regulation (i.e. enabling framework conditions). These different levels provide IFAD with a menu of potential points of engagement within a clear framework, making the policy a much more useful and immediately comprehensible document for those called upon to design and support the implementation of rural financial service programmes.
6. It is also significant that the policy underlines the importance of cooperation and partnerships with other development agencies. This promotes the harmonization and coordination agenda contained in the Paris Declaration on Aid Effectiveness.

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<sup>1</sup> See document EC 2006/46/W.P.2.

<sup>2</sup> In the context of the Report of the Chairperson of the Evaluation Committee.

<sup>3</sup> See paragraph 20 in the minutes of the meeting of the Executive Board (document EB-2006-89).

<sup>4</sup> See paragraph 47, point (iv).

<sup>5</sup> The ACP recommended an update of the 2000 Rural Finance Policy. However, the 2009 proposal goes beyond that, as it is a new policy that builds on the 2000 corporate policy and takes into account the CLE results.

The policy identifies some potential partner institutions for promoting innovative approaches and delivery mechanisms for the provision of rural financial services in remote rural areas.

7. While, overall, the document provides a wealth of information, the policy would benefit from the inclusion of greater detail, which would add context and clarity. At some point, a complementary IFAD corporate document should map out the institutional landscape (e.g. identify the main institutional players, their fields of expertise and potential synergies with IFAD)<sup>6</sup> and discuss IFAD's experience to date with rural finance. This document could also define IFAD's comparative advantage in the sector and how this translates to the three proposed levels of intervention described above. This would strengthen the policy, delineate more clearly IFAD's role in rural finance, and highlight potential partnerships with other development organizations.
8. **Specific comments.** As mentioned, the policy articulates IFAD's overall approach and direction in rural finance. In some places, however, the document goes beyond the scope of a policy statement on rural finance. For example, one could argue that some elements found in section V on *Guidelines*<sup>7</sup> might be better placed in a single "go-to" document (e.g. the IFAD Decision Tools for Rural Finance) aimed at providing operational guidance to staff and others in implementing the policy through IFAD operations.
9. With reference to paragraph 13 of the policy – which implies that there are limited prospects for direct involvement by commercial banks in the provision of rural financial services to IFAD's target group – evaluation experience has documented that there are indeed positive experiences of commercial banks serving IFAD's target groups directly (see completion evaluations of the Tamil Nadu Women's Development Project in India, the Rural Development Project in Georgia and the Qinling Mountain Area Poverty Alleviation Project in China and the experience of ongoing projects). Clearly, there is evidence that commercial banks can play an incremental role in support of IFAD operations under specific circumstances. OE would therefore encourage the policy to build upon these useful experiences with commercial banks in IFAD's rural financial services projects and programmes.
10. Section VI on *Implementing the Rural Finance Policy – implications for IFAD* is critical in determining how the policy will be operationalized. This section would have benefited from a more detailed discussion of the resources required to realize the priorities identified in the document (e.g., monitoring for results, strengthening and documenting IFAD's rural finance capacities and knowledge) as well as the measures needed to roll out the new policy, including a dissemination and outreach plan to sensitize international and country-level partners.
11. Introducing the policy (e.g. refer to the indicators in the section on *Monitoring for Results*) will have consequences for the broader self- evaluation system at IFAD, including the quality enhancement, assurance and supervision processes, mid-term reviews, project status reports and project completion reports. These processes will have to be fine-tuned so that they can capture results against the specified indicators. This will in turn facilitate aggregation and reporting by Management on the health of the rural finance portfolio at the corporate level. With regard to the latter, Management may wish to adopt a specific set of indicators for the policy and feed them into the overall corporate results measurement framework, thereby making it possible to monitor implementation.
12. One of the policy's guiding principles is to work at the macro level through policy dialogue to promote an enabling environment (e.g. in terms of developing national

<sup>6</sup> Given the rapid evolution of the rural finance institutional landscape, it may be more opportune for the forthcoming Decision Tools for Rural Finance to address the issue of institutional mapping.

<sup>7</sup> For example, guidance to "assess the demand for financial services".

policies and strategies including appropriate legal, regulatory and supervisory framework for rural finance). Such a goal is both crucial and challenging for a relatively small organization like IFAD, especially in large countries. The need for strategic partnerships in such situations cannot be overemphasized. Overall, a differentiated and context-specific approach, as outlined in paragraph 21 of the policy, should be taken in implementation.

13. Another factor that needs attention is the implications for ongoing country strategies and operations. That is, following the policy's approval, it may be useful for the Fund to conduct a quick assessment of its portfolio (especially recently adopted country strategic opportunities programmes, and projects and programmes) to determine whether they are in line with the new policy, and undertake any corrective measures (i.e. retrofitting them) required.
14. It is noteworthy that the policy explicitly addresses the issue of gender equality and women's empowerment. As noted in paragraph 19 of the policy and demonstrated through extensive evaluation experience, women's livelihoods and incomes have improved exponentially with access to sustainable rural finances.<sup>8</sup>
15. On a more general note, it is recommended that, when a revised or new policy has been preceded by an evaluation, the ACP should be attached as an annex to the document that is to be submitted for the Board's approval. This would allow Board members to assess the extent to which evaluation recommendations have been incorporated by Management in new policy proposals. In fact, this would be consistent with the approach adopted by the Board in considering new results-based country strategic opportunities programmes, which are submitted with the corresponding ACP from OE's country programme evaluations, where available. A copy of the executive summary of the evaluation of the Rural Finance Policy and the ACP are therefore attached to this document for ease of reference (see annex I).

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<sup>8</sup> The RFP also indicates, in footnote 9, that gender-specific guides are currently being produced.

## **IFAD's Rural Finance Policy Corporate-level Evaluation Agreement at Completion Point**

### **I. Introduction**

16. This Agreement at Completion Point (ACP) was drawn up at the end of the Corporate-level Evaluation (CLE) of IFAD's Rural Finance Policy (RFP) and operations. The ACP represents the IFAD Management's agreement on the evaluation's main findings and to adopt and implement its recommendations. The methodology of the CLE was developed at the end of 2005. The phases of the evaluation (namely preparation, fieldwork, reporting, and providing feedback) took place between February and November 2006.
17. The CLE addressed three questions: (i) does the RFP meet best practice standards of the rural/microfinance industry and provide practical guidance to IFAD operations; (ii) has the RFP been put into practice; and (iii) has IFAD deployed the right resources, instruments, and processes to implement the RFP? The scope of the evaluation included the RFP and supporting documents, IFAD corporate policies and strategies, all 6 regional strategies, country strategic opportunities papers, and an in-depth analysis of 58 projects in the 20 countries included in the CLE. Projects in ten of the countries were visited.
18. The CLE was carried out by a team of independent evaluators, who worked under the guidance of the Deputy Director, Office of Evaluation. It benefited from the interaction with International Fund for Agricultural Development (IFAD) staff and managers and from the feedback of the core learning partnership, in which all divisions of the Programme Management Department (PMD) and of the Policy Division were represented.

### **II. Main Findings of the Evaluation**

19. **Financial Services are Important to Rural Poverty Reduction. Still, Only 10 per cent of the Rural Poor Have Access.** Financial systems have seen great changes in the past ten years that have left most developing country national financial systems generally stronger, but not typically to the benefit of the rural poor. Microfinance has emerged as a potential pro-poor financial sector counterweight to these developments, but its application to rural areas has neither been straightforward nor rapid. As a result, access to financial services is extremely limited in most rural areas, leaving millions of rural poor dependent on no or inappropriate financial services, to their own detriment and that of rural development in general. While not a panacea to poverty reduction, rural financial services go hand in hand with promoting rural development and the alleviation of poverty.
20. **IFAD – Potential Leader in Rural Finance.** IFAD's pioneering rural finance work has faced great challenges helping to establish pro-poor financial systems. It is also a sector for which IFAD has a relatively comprehensive set of ingredients (the RFP, Rural Finance (RF) Action Plan, RF Decision Tools, regional partnerships, monitoring tools, etc.) that can make up a strategic approach to sector development. Past experience, the impressive volumes of IFAD lending, the existence of the RFP and commitment to improved development effectiveness leaves IFAD potentially the most important global actor in rural finance. It is, certainly, the only one solely focused on rural areas. However, for the time being, IFAD is leading mostly in terms of the sizable level of its overall investment in this sector.
21. **RFP – Meeting Best Practice Standards in Some Areas, Not in Others.** The RFP has proven to contain a number of elements that are best practice, although some areas of the Policy lack clarity and need to be improved to meet latest best

practice standards. The RFP provided a general framework to develop regional and country strategies and project design, but without setting clear policy directions for expected norms and standards. The RFP is not sufficiently normative and prescriptive. The permissive character and ambiguity of the RFP resulted in an only limited, albeit increasing reflection of RFP principles in regional and country strategies and contributed to projects that are not fully compliant with RFP requirements. Two other main shortcomings of the RFP lie in the absence of a costing for its implementation and a requirement to retrofit ongoing projects to meet RFP standards.

22. **Progress towards Implementing the RFP.** In meeting the four challenges of the RFP<sup>9</sup>, IFAD-assisted projects performed moderately well across all dimensions. Partner Financial Institutions (PFI) sustainability was achieved in the case of 24 per cent of partner institutions – a low percentage, but comparable to that of some agencies that work in less challenging urban areas. The diversification of financial products and services and financial intermediaries showed positive, but modest results. Against the challenges of stakeholder participation and promoting conducive regulatory frameworks, little change in performance has been noted. IFAD's rural finance assistance is meeting the RFP goal of serving rural poor (albeit not the poorest of the poor, which is in line with best practice) and by serving 60 per cent women.
23. **Explaining Improvements.** Modest advances made by rural finance projects towards greater RFP conformity can be ascribed to a number of factors, which include (i) Decision Tools which set out frameworks of best practice; (ii) the Consultative Group to Assist the Poor (CGAP) donor peer reviews and subsequent rural finance action plans, which brought greater attention and focus to the strategies for improving rural finance operations; and (iii) IFAD's increasing general knowledge of best practice in rural finance, supported by publications and efforts to improve capacity. The continuous trend in improving project design and progress made in resolving some project implementation issues provides a good platform from which IFAD can address a number of outstanding issues that will further improve the performance of its rural finance assistance.
24. **Resources Limitations Account for the Slowness of Improvements.** The modest positive trend was countered by significant factors that impeded more rapid performance improvements. These factors include insufficient resource allocations, in particular from the administrative budget, to ensure an adequate amount of technical in-house expertise in rural finance. IFAD is well below par in this area compared to other international agencies active in microfinance. Human resources, though improving, still fall short of what is needed in quantitative terms<sup>10</sup> to provide the necessary support to the sizable and complex IFAD rural finance portfolio. Moreover, while the CLE recognizes the collective effort to improve rural finance activities at IFAD, by concentrating the leadership for IFAD's rural finance work into the responsibility of a single staff (i.e., rural finance technical expert in Technical Advisory Services division (PT)) the institution now faces significant key person risk. Moreover, support to rural finance activities is based on highly personalized relationships that now need to be institutionalized. Funding has also fallen short of requirements for the provision of Technical Assistance (TA), which is a key factor in the success of many microfinance projects.
25. **Fundamental Changes Necessary for Significant Performance Improvements.** Finally, there are a number of barriers to the effectiveness of IFAD assistance for rural finance. These barriers stem from IFAD's founding agreement and entail *inter alia*: mandatory lending to government rather than directly to PFIs,

<sup>9</sup> The four challenges are sustainability and outreach, financial sector diversification, policy and regulatory framework, and participation.

<sup>10</sup> The quality of the limited number of rural finance experts is high.

structure and staffing of project implementation units, as well as limited IFAD field presence and constraints on IFAD to provide direct supervision and implementation support. The forthcoming policy on supervision and implementation support is likely to change the limitations on IFAD in this respect, but whether these changes are sufficient to address the requirements of technically qualified rural finance expertise in the field remains to be seen. Unless these changes are made, IFAD's rural finance assistance is at risk of continuing to perform below expectation and, more importantly, to endanger the meagre financial resources of the rural poor, if unsustainable financial service providers are supported.

### III. Recommendations Agreed upon by IFAD

26. Based on the recommendations made in the CLE, IFAD Management agrees to take the following actions. Some of them are already reflected in IFAD's rural finance action plan, the implementation of which will be actively pursued, as per the recommendation of the CLE.
27. **Action 1: Decide to Take a Leadership Role and Define a Strategy to Get There.** IFAD Management decides to make Rural Finance an area of excellence and define a strategy to do so, through the development of effective partnerships with rural finance centers of excellence, field practitioners and donors. IFAD is committed to making the necessary investments to improve the RFP, in-house capacity, and instruments (as detailed below) to ensure the Fund lives up to its ambition.
28. **Action 2: Clarify the RFP Standards and Supporting Instruments.** IFAD [PMD] will prepare an *Update* to the RFP, which will summarize its current policy prescriptions, clarify areas that are insufficiently prescriptive, and add more recent best practice standards. The *Update* will be a stand-alone document that will incorporate the major thrusts of the present RFP, for ease of reference, and will have a maximum of ten pages and clarify in particular financial sector analysis, participation, social performance, performance-based contracts for partner finance institutions, gender, and the environment. The *Update* will be presented for information to the Executive Board (EB) in an informal session during 2007. Revisions to the supporting instruments (such as the Decision Tools) will follow the adoption of the RFP *Update* and will entail an ongoing process to continuously capture advances in the sector.
29. **Action 3:** IFAD Management does not agree with this recommendation<sup>11</sup> because requiring the divisions to prepare a detailed regional strategy would not enhance the impact of IFAD's work in rural finance, given that the challenges of rural finance are more closely linked to each national context, and not to the wider regional environment. In addition, Management concluded that a more effective way to improve the design and implementation of IFAD projects in the field would be to develop strategic partnerships with technical institutions and centres of excellence.
30. **Action 4: More Systematic and Earlier Provision of Technical Expertise in the Design Process.** PMD will also ensure that from mid 2007 onwards, all projects with a rural finance component have adequate continuous rural finance expertise available during the project identification and design process. This will be achieved through continuously improving IFAD's in-house capacity (see Actions 5

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<sup>11</sup> Embed RFP Principles into the Work of Regional Divisions. As part of the commitment to become a leader in rural finance, each regional division of IFAD will (i) undertake or update sector analyses of regional challenges to rural finance, using the CGAP macro, meso, micro framework; (ii) determine priorities within each region and translate the principles of the RFP into meaningful objectives for each of the regions; and (iii) define a strategy for achieving the rural finance objectives for each region. The regional strategies will be used at the corporate level to position the Fund vis-à-vis other development partners, and inform the update of IFAD's Rural Finance Action Plan, which provides the framework for building IFAD's in-house and outsourced capacities.



and 6) and through regional partnerships for rural finance, which IFAD has started to form as part of the RF Action Plan. The development of technical partnerships with regional RF centers of excellence will therefore be pursued and expanded (in particular in Latin America and Asia, where they are still to be defined).

31. **Action 5: Ensure that Rural Finance Operations meet RFP Standards.** PMD will ensure that the standards of the RFP Update and supporting instruments are reflected and interpreted in country context, in all new RF formulation exercises. PMD will institute a rigorous check of each new project that includes rural finance (as a component or in stand-alone rural finance projects) to ensure projects meet RFP standards. This quality check will be undertaken by PMD and result in the Assistant President, PMD, requesting revision or redesign of projects that do not meet RFP standards. In addition, the new quality assurance mechanism being developed by IFAD will include measures to check on policy compliance and quality of rural finance components. Finally, the issues paper prepared for the OSC meetings will continue to cover compliance issues, but be updated to reflect new requirements of the RFP *Update*. The results of these quality checks will be reported to the EB in the annual Portfolio Performance Report to inform the EB of the quality of new project proposals. This system will be developed in 2007.
32. **Action 6: Build Greater Capacity.** PMD commits itself to develop in 2007/2008 (and provide the required funding to do so) a short 2-3 days basic course on rural finance, as part of the Rural Finance Action Plan. This course will be offered on a regular basis (at least twice per year) and be a requirement for all staff designing or managing projects with rural finance components. It will include, among others, modules structured around the key messages of the RFP Update, RF Decision Tools, the MIX, how to optimize the use of IFAD funding instruments, innovative product design, key policy issues etc. The modules will be continuously updated and expanded to keep them in line with latest industry developments. Staff will be required to attend training and their participation in training will be acknowledged in their annual performance evaluation.
33. **Action 7: Allocate Commensurate Resources to Rural Finance and Reduce Key Person Risk.** IFAD commits to ensure that the position of the senior technical advisor for rural finance will be selected as soon as possible, preferably by April 2007<sup>12</sup> and that all necessary steps will be taken to move the two current RF positions from temporary status to more stable contract types and funding sources, to ensure continuity of essential expertise (e.g. for monitoring the partnership with the MIX and maintaining essential thematic and regional partnerships). As a second step and in order to mobilize the means necessary to fully implement the actions recommended by the CLE and accepted in this agreement at completion point, PMD will deploy all necessary means to create two additional professional positions in 2007/2008 to provide the required in-house technical expertise. In parallel and as a potential alternative support mechanism, PMD will seek to replace departing staff with new staff with strong technical skills, including in rural finance, in order to enhance the technical capacity within regional divisions in this area.
34. **Action 8: Mainstream the Use of the MIX<sup>13</sup> as a Reporting Platform for RF across IFAD.** As part of IFAD's RF Action Plan, PMD will ensure that the global partnership between IFAD and the MIX continues at least over the next three years, in order to mainstream the use of the MIX as the reporting platform throughout IFAD RF programs<sup>14</sup>. PMD will secure the required funding to that effect.

<sup>12</sup> The current incumbent has taken up a position with UNCDF, starting February 2007.

<sup>13</sup> Microfinance Information exchange: a web-based platform enabling MFIs to report on their outreach and overall performance.

<sup>14</sup> The MIX captures, among other ratios, all the RIMS indicators set up by IFAD in the area of rural finance.

35. **Action 9: Develop More Relevant Instruments, Better Delivery, and Stronger Supervision.** To meet the more fundamental challenges that the CLE identified<sup>15</sup>, which may require amending IFAD's founding agreements and therefore interaction with and guidance from member countries, IFAD Management will organize opportunities for interaction with its EB on best practice for rural finance and the implications that IFAD faces when aiming to meet them, as well as practical change processes required to (i) optimize the use of IFAD funding instruments, including for increased provision of technical assistance and (ii) improve project implementation mechanisms through testing alternative modalities to the standard "project management unit" approach. The EB may decide that amendments to IFAD's founding agreements are needed to implement those changes. IFAD management is prepared to submit a relevant proposal to the EB and the Governing Council on this subject.<sup>16</sup> Management is also ready to involve the EB in regular ad-hoc seminars on relevant issues in rural finance on the margin of scheduled sessions. Such EB seminars are included in the PMD departmental management plan.
36. **Action 10: Gain Greater Relevance through a More Efficient and Effective Process.** To shorten the project cycle (including from approval to effectiveness), IFAD will pilot, as part of the implementation of its corporate Action Plan, a shortened project cycle that will also concern a selected number of rural finance project. The pilot will aim to reduce the total time from inception to start-up to less than 24 months and to reduce project design documentation to 50 pages in total. Details of the pilot process will be determined in 2007 and implemented over two years.

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<sup>15</sup> These challenges include working more directly with partner finance institutions; placing responsibilities for project management in institutions that are technically better qualified to supervise financial sector projects; and using larger amounts of loan money for the provision of technical assistance.

<sup>16</sup> The evaluation had originally recommended that IFAD establish an EB working group on rural finance. According to the evaluation, this working group could provide a platform to discuss with EB members best practice for rural finance and the implications that IFAD faces when aiming to meet them. However, while management recognizes the importance of interacting with the EB on key issues and challenges in rural finance, they recommended that IFAD avoid establishing additional working groups of the Board.

