# ACCESS TO FINANCE
## Rwanda

## MICROFINANCE CHALLENGE FUND RWANDA
## END OF PROJECT EVALUATION

### INTRODUCTION

Genesis Analytics was contracted by Access to Finance Rwanda to conduct the end of project evaluation for the Microfinance Challenge Fund Rwanda (hereafter "the Fund"), and to conduct a feasibility study for furthering the activities of the Fund.

### PURPOSE OF EVALUATION

- A holistic review of the Fund and its projects;
- An account of how the Fund has performed;
- An assessment of the degree to which its objectives have been achieved.

The findings of the evaluation provide an input into a feasibility analysis for a second phase.

### EVALUATION METHODS:

The overarching approach to the evaluation amalgamated three methods and approaches:

# BACKGROUND TO RWANDA MICROFINANCE

The Rwandan Microfinance sector began to develop in 1975, and experienced rapid growth from the late 1990s. This growth has been attributed to a large inflow of donor funds directed towards relief oriented microfinance initiatives (following the genocide in 1994), as well as the provision by the Government of Rwanda of credit lines and grants to the microfinance sector to fast-track reconstruction. This rapid growth occurred in an unregulated system and ultimately led to instability within the sector, prompting the Government to launch a financial sector reform programme in 1995. However, in 2006 the limited success of these reforms was made apparent by the collapse of 9 MFIs that lead to 195 000 depositors losing their savings. This caused the Government to adopt a formal National Microfinance Policy, accompanied by an implementation strategy, in September 2006.

To strengthen the microfinance sector and better protect public deposits, a specific microfinance law (Law No. 40/2008) was adopted by the Rwandan parliament in August 2008, followed by the publication of a new BNR Instruction for MFIs (No. 02/2009). The law defined the National Bank of Rwanda (BNR) as the main regulatory body overseeing the microfinance sector. According to the BNR, the total number of MFIs declined in December 2016 to 472, from 494 in December 2015. This decline is due to the restructuring of networks of SACCOs that changed their legal status to two limited liability companies. Ten SACCOs were also liquidated and their depositors refunded by the Government in December 2016. Of the 472 MFIs operating in Rwanda, 17 have limited liability company status; 455 are SACCOs: these include 416 Umurenge SACCOs and 39 non-Umurenge SACCOs.

The MFI sector balance sheet continued to expand in 2016, with total assets of the sector increasing by 6,6% in December 2016 to FRW 223 billion. This is significantly lower growth than the 31% increase in assets in 2015. The slowdown of growth of microfinance assets was partly explained by Rwanda Social Security Board’s (RSSB) decision to transfer “Mutuelle de santé” funds from Umurenge SACCOs to accounts in its banking division for better management of these funds with automated operating systems. A total of FRW 13 billion was transferred.

The share of loans over total assets of the sector increased from 53% in December 2015 to 57% in December 2016. The reduced pace of lending from MFIs is due to an increased vigilance surrounding prudential lending caused by credit risk concerns arising from poor agricultural performance in 2016. However, agriculture remains a key lending sector for MFIs and accounts for 30% of Umurenge SACCO loans and 15% of total MFI loans.

## Reported challenges facing MFI’s

### Supply side

1. Lack of skills
2. Poor product design
3. Weak risk management
4. Low transparency levels
5. Short savings cycle

### Demand side

1. Lack of collateral
2. Low financial literacy
3. Geographical isolation
4. Low incomes
5. Poor savings

# THE FUND

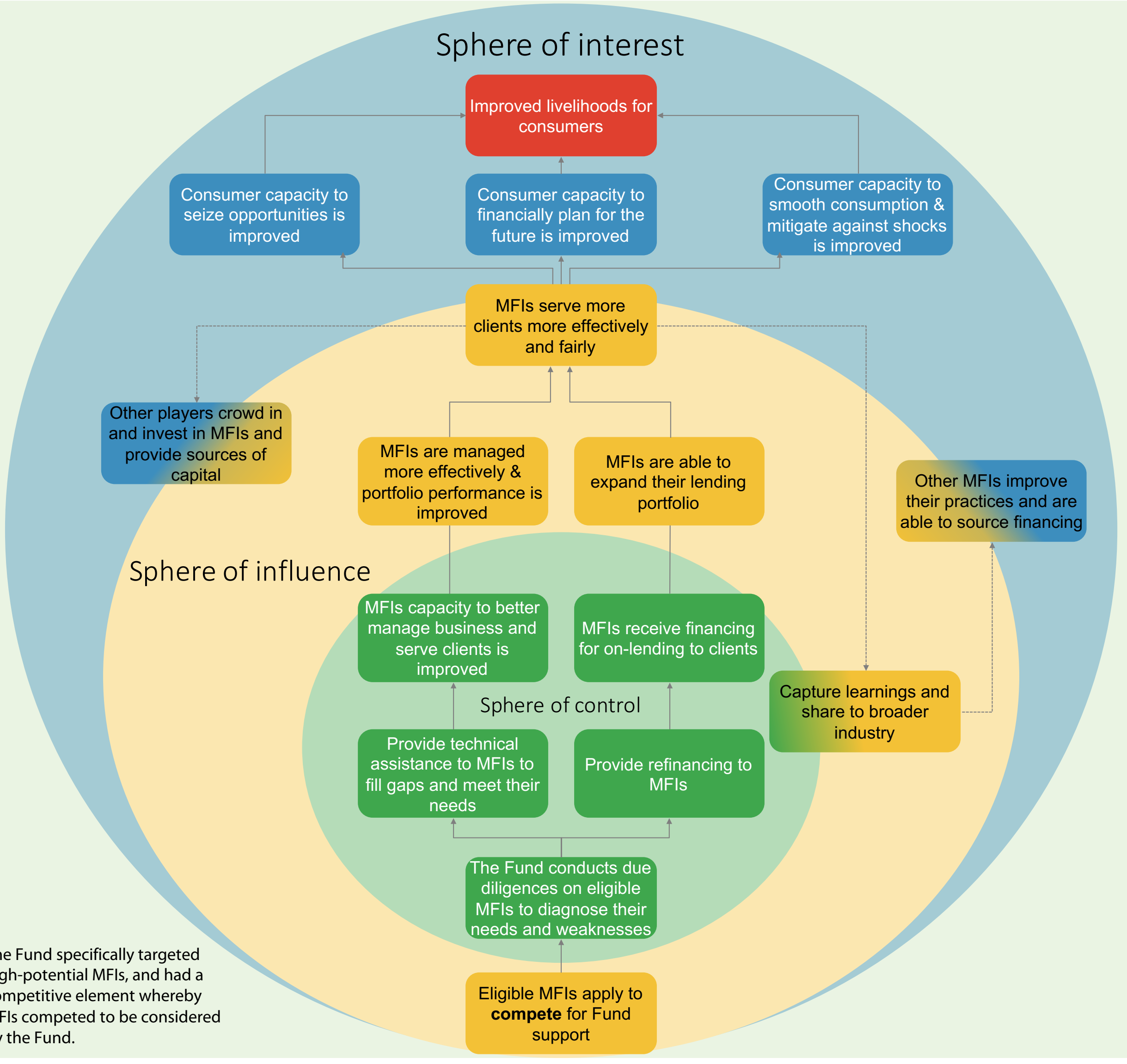
In 2009 KfW conducted a project appraisal for an intervention in the microfinance sector in Rwanda, and subsequently designed a project to support MFIs to serve customers better and source funding for their business operations. To address the market's inability to self-correct on these two issues, KfW signed a grant agreement with the Government of Rwanda for €3 million to be channelled through AFR for the support of MFIs, and in April 2014 the Microfinance Challenge Fund was established.

## What the Fund does

Funds **TECHNICAL ASSISTANCE,** consisting of a tailored package of support to selected MFIs to build their capacity to better manage their business and function more effectively.

Provides **REFINANCING** to the selected MFIs to be on-lent to increase the size of their portfolios in the rural areas of Rwanda.

## The Fund's theory of change




The Fund specifically targeted high-potential MFIs, and had a competitive element whereby MFIs competed to be considered by the Fund.

# WHAT IS A CHALLENGE FUND?

A challenge is defined in the Oxford Dictionary as "A call to someone to participate in a competitive situation or fight to decide who is superior in terms of ability or strength." The key of the definition is the reference to parties competing in performing some task. Eloquently distilled by O'Riordan *et al*, the core principle of a challenge is that "one agency defines a goal, but invites others to achieve it."[1] Therefore, simply put, a challenge fund is one whereby an agency defines a goal, and funds others, on a competitive basis to achieve the goal. DFID, IADB, and CIDA define a challenge fund as:

> *"a competitive mechanism to allocate financial support to innovative projects, to improve market outcomes with social returns that are higher/more assured than private benefits, but with the potential for commercial viability"*[2]

Though, the most widely accepted *detailed* definition of a challenge fund comes from SIDA:

> *"A challenge fund is a financing mechanism to allocate funds for specific purposes using competition among organisations as the lead principle. A challenge fund invites companies, organisations or institutions working in a targeted field to submit their proposals.*
>
> *Challenge funds are often set up to meet specific objectives, such as extending financial services to people in poverty; finding solutions to a specific health problem in developing countries; as a means of triggering investment to certain high-risk markets; and, to stimulate innovation for effective use of water resources. The scope of using challenge funds for creative problem-solving in development is very wide and holds considerable potential.*
>
> *Proposals are assessed against transparent and pre-determined criteria. Successful applicants must usually match a certain percentage of the grant with own financing. The challenge fund awards grants to those projects that best meet the objectives of the fund and fulfil various pre-established eligibility criteria."*[3]

While within these definitions, there remains considerable flexibility in both the design and objectives of a challenge fund, there are also several important characteristics that all challenge funds share.

## Key Challenge Fund principles

### 1 COMPETITION

The key principle of a challenge fund is competition. The mechanism uses competition to find the most *cost-effective* solutions to accomplish specific development goals.

### 2 WIDE PROMOTION & SUPPORT

Since competition is the essence of a challenge fund, it is vital to ensure that there is a sufficient pool of proposals to evaluate. A limited choice of proposals means less competition and potentially the selection of sub-standard investments.

### 3 INNOVATION

The non-prescriptive nature of a challenge fund means that they are often associated with promoting, incentivising and financing innovation. How to achieve the desired outcome should not defined, as this opens the door to new ideas.

### 4 LEVERAGE AND OWNERSHIP

To limit the risk of 'moral hazard' and to ensure shared ownership and commitment, recipients of challenge fund support are almost always required to match a proportion of the grant with their own funds or an in-kind contribution.

### 5 MEASURE & LEARN

Since challenge funds are primarily funded by public money, grants should result in the generation of knowledge, lessons and solutions. Thus, a considerable amount of resources should be invested into learning activities.

### 6 ADDITIONALITY

To have maximum impact, challenge funds should aim to only support initiatives that would not have taken place without their support, because other funders consider the risk of failure too high or the projected financial return is too low.

[1] Anne-Marie O'Riordan, James Copestake, Juliette Seibold, & David Smith (2013) "Challenge Funds in International Development", Research Paper

[2] Claudia Pompa (2013), "Understanding challenge funds", ODI

[3] SEDA

# KEY EVALUATION FINDINGS

## Analysis framework

To answer all the evaluation questions Genesis used an analysis framework to organise all data and information collected through the various evaluation processes. The analysis framework used the DAC Criteria of *relevance*, *efficiency*, *effectiveness*, *impact* and *sustainability* with the addition of the '*economy*' criterion.

## Relevance

Relevance asks the question: Does the Fund meet the needs of the sector, is it designed to achieve its purpose: will its activities, in theory, lead to sustainable improvements in the lives of poor people in Rwanda?

The following was found:

### CONSTRAINTS FACING MFIS

#### MFI-level constraints

1 Weak Governance: risk to financiers

2 Strategic direction: rural areas not a priority

3 Operational efficiency: weak internal systems

4 Knowledge and skills: don't have client centric skills

5 Access to capital: high cost of capital

#### Client-level constraints

6 Clients have limited to no collateral

7 Clients engage in riskier sectors

8 Low financial literacy & poor repayment culture

#### Other constraints

9 Physical infrastructure: limited connectivity, no electricity, bad roads

10 Risk averse financiers: Limited to no risk taking or ticket sizes too small

### FUND DESIGNED TO ADDRESS THESE

**TAILORED TECHNICAL ASSISTANCE:** Provide governance support, strategic training, assistance with setting up and using systems, training on client centricity and product development to overcome constraints

**REFINANCING** Provide refinancing at an affordable, but non-distortive rate to stronger MFIs to overcome the limited access to capital

**LEARN AND SHARE** Capture lessons on what works and doesn't and share so other MFIs can copy. Prove the business case for financing MFIs and crowd in other financiers

**Can't be everything to everyone** The Fund cannot directly address the infrastructural barriers, and cannot provide financing to everyone

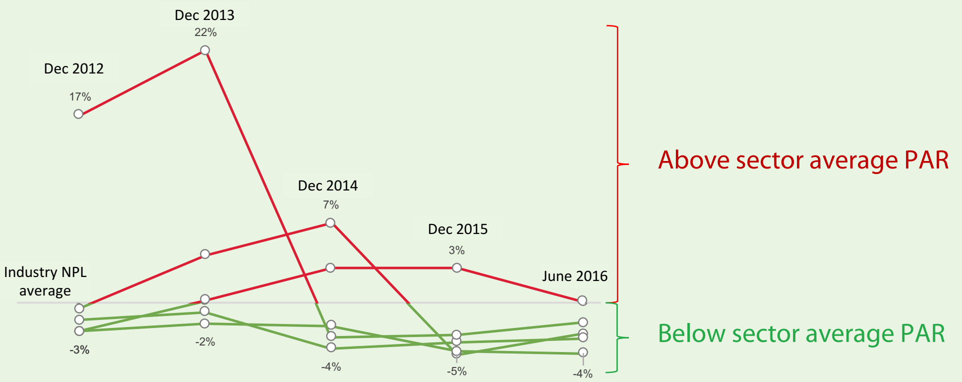
# KEY EVALUATION FINDINGS

## Effectiveness

Effectiveness asks the question: Did the Fund meet its targets and what contributed to and detracted from its success?

### Meeting targets

| | |
|---|---|
| Implement max. 5 interventions with MFIs | ✓ |
| EUR 2 million committed to MFI support | ✓ |
| 150 000 New active clients (savers and borrowers) | ✓ |
| 40% of supported MFIs' loan portfolio is in rural areas | ✓ |
| 40% of supported MFIs' savings portfolio is in rural areas | ✓ |
| Supported MFIs average Portfolio at Risk (PAR > 29 days) is less than 5%<br>By June 2016, all most all supported MFIs had a lower NPL than the industry average | X |




### Success drivers

1
Leveraging AFR:
*Being domiciled within AFR drove the efficiency of the Fund by leveraging existing infrastructure and management structures, such as its office space, human resources and investment committee. It was also reported that this drove the effectiveness of the Fund through AFR's good reputation in the sector*

2
Strong management:
*The management of the Fund has been noted as being a key driver to the well-running of the Fund, specifically the use of Frankfurt School of Finance and Management as the Fund managers was lauded. This allowed for the use of existing tools and expertise of the School.*

3
Laser focus:
*Being focused on a small number of institutions has been identified as being a contributing factor to the success of the Fund. This allowed the Fund to provide deep support to the MFIs; however, given its limited reach, the Fund could have focused more on sharing the lessons from these few institutions.*

4
Tailored TA & quality consultants:
*Conducting assessments of the MFIs and then tailoring the support provided to them was not only identified as a key success driver, but also as a unique delivery mechanism in the sector. This was strengthened further by the selection of professional and quality consultants.*

### Detractors of success

Stringent eligibility criteria and a weak sector:
*The primary barrier to the success of the fund has been identified as its stringent eligibility criteria, matched with a fundamentally weak sector and small MFIs, which severely limited the pool of eligible MFIs.*

Risk aversion:
*The Fund is criticised for only picking the strongest MFIs in the sector, where there are other high-potential, but smaller MFIs that could potentially reach deeper into the rural areas.*

Delayed start:
*The original diagnostic for the Fund was conducted in 2009, but the Fund was only established in 2014 and the sector had changed somewhat during this time.*

A limited focus on the end-user:
*There was a reported lack of focus on the end-user and their needs, which is evident in the targets and key performance indicators of the Fund.*

# KEY EVALUATION FINDINGS

## Efficiency and Economy

Efficiency asks the question: Was the Fund managed efficiently, did it meet its objectives on time and at a reasonable cost?

### Management good practices

To assess the efficiency and economy of the management functions of the Fund we assessed the Fund's performance against the best practices identified previously:

1
Fund policies and procedures are captured in a comprehensive manual: *while the project origination, application process, eligibility criteria, due diligence, and support processes are clearly documented in Fund manuals; the decision-making process of the AFRIC is not well documented.*

2
Grantees are provided with clear guidance and feedback on reporting: *All benefiting MFIs, except one, reported that the reporting requirements were not burdensome and were largely in line with what they are required to report to BNR.*

3
The financial management lends itself to transparency: *The systems put in place to disburse and manage the financial resources are transparent and do not require that the Fund ever sits with large sums of money unallocated.*

4
Inputs are sourced at competitive rates and quality is ensured*: There is an open tendering process involved in the selection of consultants for the technical assistance component of the Fund. This process ensures value for money.*

## Impact and Sustainability

Sustainability and Impact ask the question: Has the fund catalysed systemic change and how has it impacted on the beneficiary?

### Systemic change

The Fund can catalyse systemic change through three primary mechanisms:

Crowding in other financiers:

While there is limited to no evidence of crowding in at this point, and there is evidence of potential short-term crowding out; it is important to note that the support offered by the Fund has not yet come to an end and that systemic changes of this type typically take longer to develop. It is possible that even if the Fund temporarily crowded out some funding, in the future the improved capabilities of the MFIs may lead to even larger credit lines being offered. This remains to be tested and should be considered by AFR going forward.

Capturing and sharing lessons

The lessons learnt through the implementation of the Fund, focus on its performance and hindrances, as opposed to lessons for the sector. Extracting and publicising lessons captured through project design and implementation are key in driving the demonstration effect and encouraging others to replicate what the Fund has done. It is important to note that some of the investments are under 18 months old, meaning that there has been limited opportunity at this point to capture these lessons. It is important that even if the Fund is to close, there remains a focus on capturing these lessons.

Building the business case

The findings suggest that once the Fund ends, it is unlikely relationships between the channelling bank and MFIs will continue, meaning that the commercial case for funding MFIs has not been sufficiently build. This is despite 100% repayments to date. This represents a missed opportunity of the Fund and the final stages of the Fund should look at strengthening this by ensuring that this business case is communicated to the banking sector. In future, having a decreasing guarantee and a stronger focus on including bank staff in assessments should be considered.

# KEY EVALUATION FINDINGS

## Impact and Sustainability continued

### Client impact

**Decrease in rural loan portfolio**

RWF 32 billion

RWF 29,5 billion

But still over 60%

**Increase in number of rural clients**

350 000

200 000

**Decrease in average rural loan size**

RWF 157 000

RWF 85 000

…but there have been average increase in financial sustainability of the supported MFIs

While there is limited data on the actual clients reached and the quality of services provided by the MFIs, the reduction in the size of the average loan in rural areas together with an increase in number and proportion of rural clients, could imply that the MFIs are in fact reaching poorer individuals than previously. Although it is impossible to determine what proportion of this is attributable to the Fund, the interviews suggest that the Fund contributed to this and it is encouraging nonetheless. The theory of change suggests that this expansion and improved access of credit empowers clients to improve their lives.

### Unintended consequences

The assessment aimed to identify any unintended consequences:

MFIs and stakeholders claimed that the due diligence activities and the output of these were themselves incredibly informative and useful for the MFIs. One MFI that did not receive technical assistance or funding, but did have an in-depth assessment performed on it by the Fund, said that it was incredibly useful to know what their weak areas were and could now find ways to fix the issues themselves.

# RECOMMENDATIONS

It is acknowledged that this evaluation comes at the end of the Fund's first phase, and so we focus on implementable recommendations for the next few months. Therefore, the recommendations are based around monitoring and learning activities, and together can form a learning agenda for the final phase.

### Focus on learning

The focus on learning has been more on the Fund's performance and hindrances than on capturing and disseminating lessons that could catalyse change in the sector to date. Extracting and publicising lessons captured through project design and implementation are key in driving the demonstration effect and encouraging others to replicate what the Fund has done. In the following six months, the Fund should focus on capturing these lessons and disseminating them through targeted and broad means to drive the demonstration effect. An example could be capturing the learning from the due diligence exercises conducted on the MFIs as part of the selection process; generalising the common weaknesses and the appropriate strategies to overcome them would form a useful input to the sector more broadly.

# RECOMMENDATIONS

## Improving on key performance indicators

The Microfinance Challenge Fund Rwanda has performed well to meet all its performance targets other than that of PAR, which has been increasing nationally over the last year. While the key performance indicators of the Fund and the associated targets are limited and do not fully capture the success of the Fund, anecdotal evidence divulged by the sector does point at a great success in improving the capacities of the MFIs in terms of their governance structures, strategic direction, skills and client centricity. To improve on its key performance indicators, the Fund could consider the addition of qualitative contribution narratives to be associated with the existing key performance indicators. Furthermore, the Fund could add specific indicators to track developmental impacts. These could include:

- The change in average rural loan size;
- The ubudehe categories of MFI clients;
- The average income of clients;
- The number of clients earning less than X a month; and,
- The number of new rural clients.

Furthermore, having a 5% PAR target is not necessarily realistic, as the macro economy strongly influences this indicator. To illustrate that the Fund has improved the quality of the supported MFI portfolios, the Fund could use a relative target, for example aiming that supported MFIs have PARs 2% points lower than the sector average. This indicator is agnostic to macro movements, which the Fund is not in control of.

## Learning at the MFIs

The Fund has been found to be relevant and effective at addressing the gaps faced by MFIs, which has been the primary focus of its activities. Although the Fund is criticised selecting only the stronger MFIs and not having achieved its full potential in terms of additionality, it is too early to tell whether the strengthening of the MFIs has resulted in crowding in of even more funding to these MFIs. While the individual MFIs are in a better position than they were before receiving support, the sector more broadly is still viewed as unattractive to banks and commercial financiers, as other MFIs are not yet able to access significant funds. In spite of the Fund coming to an end, it is vital that monitoring and learning still occur post completion. This is important given the nascence of many of the Fund’s investments, and the potential lessons that can still be learnt and disseminated to catalyse systemic change and enhance the performance of non-supported MFIs.

## Building the business case

It is unfortunate that the findings suggest that once the Fund disappears it is unlikely relationships between the channelling bank and MFIs will remain. Therefore, regardless of whether a phase two is implemented, a compelling business case should be built for banks to consider financing MFIs in the future, based on the lessons learnt through the Fund. This will require that repayments continued to be monitored and that the business case for banks be drafted.

## Measuring the impact on the end-user

The secondary result of the Fund is improved financial inclusion. While there is limited data available on the types of clients reached and the quality of services provided, there has been a reduction in the size of the average rural loan that implies that the MFIs are in fact reaching poorer individuals. The theory of change suggests that this expansion and improved access of credit empowers these people to improve their lives; however, with the limited actual data collected, this cannot be proven. Thus, the Fund could consider tracking financial inclusion indicators through the MFIs:

- The number of lower-income clients being served by the supported MFIs;
- The percentage of those lower-income clients managing to repay their loans on time;
- Number of second loans with an increased size for low-income clients; and,
- Number of clients having greater reported collateral and income.
- Important to assess if MFIs are extending their reach to the poor

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