Inclusive Rural Financial Services

IFAD
Investing in rural people

Scaling up note

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Maldives - Atolls Credit and Development Banking Project

Scaling up results for inclusive rural financial services

With almost four decades of engagement in more than 70 countries and more than US$1.1 billion invested in rural finance (RF) initiatives, IFAD has rich and multifaceted experience, a global network of partners working at the frontier of innovation and hundreds of different types of providers addressing the financial needs of poor rural households as their clients. Most of the 3 billion people in rural areas still live on less than US$2 a day. Challenges such as economic shocks, food shortages and climate change affect poor people disproportionately. Poor rural households are typically excluded from opportunities in the formal financial sector.

There is increasingly robust evidence that promoting access to inclusive rural financial services in a responsible manner has positive impacts, at the microeconomic level through improving household welfare and local economic activities and at the macroeconomic level as the degree of financial intermediation is positively correlated with growth.

For these reasons, one of IFAD's thematic priorities is to scale up the results of RF investments that are centred on poor people. IFAD's inclusive RF development operations are guided by IFAD's Rural Finance Policy of 2009. This is complemented by IFAD Decision Tools for Rural Finance and technical notes and knowledge documents on specific technical issues. The debate on how best to foster innovation and make new models robust and viable in the medium to long term is part of IFAD's corporate agenda. More specifically, one of the six guiding principles of IFAD's approach to inclusive rural financial services is to "develop and support long-term strategies focusing on sustainability and poverty outreach, given that RF institutions need to be competitive and cost-effective to reach scale and responsibly serve their clients" (Box 1).

Box 1: Six guiding principles of IFAD's RF interventions

- Support access to a variety of financial services
- Promote a wide range of financial institutions, models and delivery channels
- Support demand-driven and innovative approaches
- Encourage market-based approaches
- Develop and support long-term strategies focusing on sustainability and poverty outreach
- Participate in policy dialogues

Sources: IFAD's *Rural Finance Policy*, 2009; *Decision Tools for Rural Finance*, 2010

IFAD supports RF development through loans and grants to governments and grants to non-profit organizations. Using these two instruments, IFAD implements projects and programmes designed to address specific issues within a target market and works at the three levels of the financial market:

- At the micro level, IFAD understands that its support is most effective when products and services are demand-led, while acknowledging the productive and economic potential of poor rural people and their organizations.
- At the meso level, IFAD's interventions work to develop efficient support infrastructure for the financial sector by building both human and institutional capacity, such as through credit reference bureaux, collateral registries, mobile payment platforms and training and certification institutes for financial service providers (FSPs).
- At the macro level, the full impact of inclusive rural financial markets is felt only when conducive national policies and strategies are in place, markets are functioning and complementary non-financial services are available.

Scaling up pathways

The model of providing micro-, meso- and macro-level support to the financial system goes beyond IFAD's resources, capacity and expertise. Acknowledging this limitation, it is important to: (i) understand the level of government commitment to driving the financial inclusion agenda; (ii) define IFAD's comparative advantage in developing inclusive RF systems, the comparative advantages of other donors and their objectives and activities in promoting financial inclusion; and (iii) assess the ability and willingness of the private sector to engage in the development of an inclusive financial market.

IFAD's three main pathways to scaling up are policy engagement, project financing, and knowledge generation and sharing, which can be combined in a country programme to bring positive results to scale.

Policy engagement

To target the development of inclusive RF systems and maximize the impact of its interventions for promoting rural financial services, IFAD should encourage not only active engagement by the government but also strong donor coordination and partnering with the private sector. Private-sector partners can include industry associations – such as savings and credit cooperative (SACCO) unions, federations or associations – which can be twinned with counterparts in other countries to take advantage of technical support. Such engagement beyond government counterparts would obviously need to be aligned with existing institutional mechanisms to ensure that it supports government strategies (Box 2).

Box 2: Principles of policy engagement for IFAD-supported RF projects

- Design projects with a long-term approach to building financial systems to avoid any kind of market distortion through subsidized lines of credit, generous matching grants to fix externalities, confusion of short-term with medium-term financing issues, additional risks for FSPs through injections of cold money (refinancing sources such as external loans or grants) by governments and donors or perceptions of FSPs as only tools for achieving other development objectives rather than financial institutions that need to be sustainable and manage risks.
- Support consumer protection and the endorsement of the Consultative Group to Assist the Poor (CGAP) Client Protection Principles in Microfinance, such as through measures to promote transparent loan costs and responsible pricing, consumer education, prevention of over-indebtedness and consumer complaint mechanisms, working in concert with similar efforts at the meso level.
- Build on existing policy frameworks and dialogue (e.g. financial sector reforms) to promote the legitimacy of inclusive financial systems and access in rural areas.
- Advocate for financial inclusion with regulators to: (i) reduce barriers to market entry for FSPs, thereby increasing competition and ultimately improving the quality of services available to poor clients; (ii) allow credit-only institutions to lend without prudential licenses or supervision (but with adequate consumer protection) in cases where non-bank institutions such as NGOs need explicit legal authorization to lend; (iii) not rush to regulate; and (iv) only regulate what can be supervised. Work with partner governments to adjust the regulatory and supervisory framework for deposit-taking institutions (e.g. cooperatives, postal banks), without pushing for premature or restrictive legislation. Before recommending prudential regulation, make sure that it is truly necessary for protecting the safety of savings, that there is a critical mass of retail institutions qualified for such regulation and that there is sufficient supervisory capacity to monitor and enforce regulation. RF policies should be integrated into broader financial-sector strategies.
- Support interest-rate liberalization through education and advocacy, both directly and by working with stakeholder networks, while encouraging FSPs to work more efficiently to bring down transaction costs and thus interest rates.
- Do not support the direct provision of credit services by governments, such as government-mandated portfolio quotas, directed credit, borrower loan guarantees or operational subsidies. In some cases, an exception may be considered for providing financing, subsidies or guarantees to well-run FSPs that are unable to obtain sufficient financing from local capital markets.

Policy engagement and macro-level interventions in general often require advisory capacity and longer-term commitment. They also usually require the consistent presence of highly skilled technical service providers. Macro-level interventions typically require the additional support of an influential public or private advocate – a so-called "driver" – to spearhead reform. Advocates can come from the ministry of finance, the central bank or a domestic microfinance network. Advocates need to fully understand what regulatory reform entails, its potential effects and whether it will result in a conducive, pro-poor framework for the RF sector.

Possible IFAD-supported interventions in RF at the policy level are to:

- participate in policy dialogues on creating an enabling environment for RF by addressing market failures and key issues such as the legal framework for regulated local financial institutions, reform of state banks and credit cooperatives, liberalization of interest rates and facilitation of deposit-taking for member clients or public customers
- work with partner governments on the development of policies and strategies that are in line with international good practices for RF and principles for building a stable financial system and that establish appropriate legal, regulatory and supervisory frameworks for protecting savers and creating a level playing field among deposit-taking institutions; IFAD can also engage members of the government and civil service in important RF issues (e.g. the pricing of cost recovery) to inform and influence political decision-making
- build the capacity of key government staff in ministries of finance and central banks; IFAD-supported interventions can also assist partner governments in establishing or improving the wider institutional capacities needed to provide vital regulation, supervision and oversight functions for the RF sector
- support transparent, enforceable improvements in the legal framework for loan collateral requirements, taxation and registration of rural FSPs; these important modifications can facilitate access to finance, particularly for women
- work with the registrar of cooperatives and other key players on improving the supervision of credit unions and SACCOs; this could involve improving the cooperative law to facilitate compliance with regulations, the implementation of risk-based supervision and technical assistance from experts in the formulation of cooperative law policy and in on-site monitoring and supervision of credit unions.

In a number of countries, good practice is to establish platforms for dialogue on financial-sector policy across the industry, including government, donors, the private sector and other stakeholders, to enhance the dialogue and advance common goals (Box 3*)*.

Box 3: A more inclusive financial sector in Ghana

Since 2010, IFAD has been supporting the national Rural and Agricultural Finance Programme (RAFiP) in Ghana. The programme addresses its two technical components holistically through interventions targeting the macro, meso and micro levels. Meaningful changes have occurred in the context within which RAFiP functions, such as: (i) the central bank's increased role in regulating rural microfinance institutions (MFIs); (ii) the government's embracing of the Maya Declaration on Financial Inclusion; (iii) increasing self-sustainability of the apex bank of rural and community banks; (iv) strong support to access to services for low-income households and microenterprises under Ghana's second Financial Sector Strategic Plan (FINSSP2); (v) updating of IFAD's country strategic opportunities programme (COSOP) to strengthen policy dialogue for the higher aspirations of achieving (strategic) objectives, enhancing impact and sustaining outcomes; (vi) formalization of value chain relationships, including financing; and (vii) donor support to IFAD for the programme.

FINSSP2 is meant to serve as a blueprint for the changes in Ghana's financial system from 2012 to 2016 on which IFAD has focused its policy engagement in partnership with others. Through RAFiP, major weaknesses in the financial system that impede Ghana's economic growth were noted and have been addressed in ten priority areas of change. To develop the policy dialogue pathway for scaling up, RAFiP engages actively in the preparation of the National Financial Inclusion Strategy, particularly in making sure that the principles for good practice microfinance – including consumer education and protection and innovative applications of technology to support rural outreach – are adequately incorporated and implemented to provide the foundation for scaling up proven methods under future initiatives, projects and programmes.

Through engagement in the 2013 joint agriculture sector review and dialogue process for the development of Ghana's Medium-Term Agriculture Sector Investment Plan, IFAD has provided guidance and principles for leveraging private-sector investment and access to finance for agricultural value chains, and respective budget preparation that enables scaling up of RAFiP's major results.

Source: IFAD. 2014. *Mid-Term Review – Rural and Agricultural Finance Programme*. Rome

In addition to IFAD's approach to internalizing the scaling-up agenda into its operational model, recent developments have also influenced IFAD's capacity to identify scalable models and assume a leading role in bringing them to scale.

The first of these developments involves liberalization of financial sectors and the state's retreat from majority ownership and management of financial institutions and delivery of associated subsidized credit through state-owned banks. Instead, financial inclusion and pro-poor financial services and institutions have become the major policy direction in RF support. More than 90 countries, representing 75 per cent of the world's "unbanked" population, support the Maya Declaration – the first set of global and measurable commitments made by developing and emerging country governments to unlocking the economic and social potential of the world's 2.5 billion unbanked people through greater financial inclusion.

Second, many FSPs that were set up in the 1990s have now matured or left the rural marketplace. Sound business models, improved integration into the financial sector (instead of parallel arrangements) and better control of service costs and lending risks characterize the more mature microfinance subsector. IFAD encourages these maturing FSPs to expand their outreach and market base in rural markets so that poor rural people benefit from the FSPs rather than seeing them exit the rural market.

Third, associations of development agencies working for financial inclusion have become more important over the past two decades. Such associations include public-good centres of excellence and IFAD's partners such as CGAP, the Capacity Building in Rural Finance (CABFIN) Partnership, Making Finance Work for Africa (MFW4A) and the Alliance for Financial Inclusion (AFI). These networks are used to spread emerging good practices and obtain ideas for new and innovative practices from other development agencies.

Fourth, increasing sophistication of the main actors and a new emphasis on partnerships and coordinated action mean that promising and robust models and processes for scaling up are now usually identified in partnership with different providers of financing and technical assistance.

Fifth, IFAD has developed knowledge and experience in policy engagement in new and emerging areas related to the development of financial systems, which enable new products such as index insurance and expanded services for remittances (IFAD, 2013; IFAD and WFP, 2010).

Sixth, the landscape of support to RF in developing and emerging country economies is changing and offering diverse opportunities and challenges through new types of partnership among public, social and private investors. For example, Islamic finance models that focus on equity stakes rather than the classical transactions based on profit maximization are now in greater demand in some of the countries with the largest populations in Asia and sub-Saharan Africa (Zander, 2012).

Project financing

The 2007 corporate-level evaluation of IFAD's Rural Finance Policy of 2000 found that projects that attempt to tackle many different development objectives tend to scatter programme resources and do not dedicate the required attention and capacity to developing sustainable RF systems. It was, therefore, recommended that a more effective approach is to focus on stand-alone RF programmes rather than includ an RF component in wider programmes as a means of achieving another development goal. For example, if the target group of an IFAD-supported project on agricultural technology needs credit to purchase crop inputs, linking the group to an existing FSP would be more effective and sustainable than inserting an RF component into project activities, which would ensure credit provision for only the duration of the project. In this example, if no suitable FSP is currently serving the target group, or if the right credit product does not exist, a more responsible approach would be to link activities to a stand-alone project in the country or to make sure that an RF component focuses on developing existing services to improve outreach and/or provide more appropriate products. An RF component can work when properly designed and implemented – especially if there is no other RF project and/or if services and appropriate products for the target group are lacking.

As mentioned in the introductory section of this note, to ensure sustainability, interventions should be made at all levels of the financial system – micro, meso and macro. For IFAD, engaging at the macro or meso level should be contingent on whether the intervention would be critical to the expansion of retail financial services. For example, effective micro-level efforts often call for changes in the enabling environment to maximize their long-term impact and sustainability or they require reorganization and/or capacity-building at the meso level. However, IFAD-supported RF projects can fall into the trap of focusing on just the micro level or they struggle to devote the required attention and resources to the whole sector. To overcome this challenge, IFAD-supported projects can leverage other actors in the financial sector so that project resources can be directed to where IFAD has a comparative advantage. For example, FSPs – MFIs, banks, insurance companies, etc. – participating in IFAD-financed projects can be mobilized as levers using their own financial resources for a project-tested innovation, product or delivery channel. If this is not possible, efforts should be made to ensure strong donor coordination at multiple levels of the financial system (Box 4) and to establish partnerships with national microfinance associations for more effective advocacy at the macro level. Special microfinance vehicles such as money transfer operators for remittances, and depositors, should also be considered part of efforts to ensure that financial inclusion goes to scale after a project ends.

Knowledge generation and sharing

Systematic knowledge management and learning (including through web portals) are essential as scaling-up pathways. Knowledge sharing and knowledge management can serve several purposes in scaling up RF approaches, for example – at the global industry level – through setting standards for financial and social reporting, advocating for client protection and/or advancing product development through experimentation with innovations or carrying out applied research. Over the years, IFAD has invested continuously in knowledge partnerships through its grant instruments, spurring innovation and advancing knowledge and solutions that promote responsible and inclusive rural financial systems. Regional and global partnerships have evolved into a comprehensive knowledge management network. IFAD's current partners include CGAP, Développement international Desjardins (DID), the Microfinance Information Exchange (MIX), the Participatory Microfinance Group for Africa (PAMIGA), MFW4A, the

CABFIN Partnership, the Microfinance Centre for Central and Eastern Europe and the New Independent States (MFC), the Asia-Pacific Rural and Agricultural Credit Association (APRACA) and the African Rural and Agricultural Credit Association (AFRACA). These partnerships allow IFAD to pursue the scaling up of inclusive rural financial services through its knowledge management agenda and to mainstream its interventions into national financial inclusion programmes.

It goes without saying that exchanging knowledge on best practices and lessons from IFAD's interventions at the national, regional and South-South levels is also crucial to scaling up, in both influencing policymakers and serving as models for replication. However, pure replication from another country or region to a project area often does not work in RF. Attention should be paid to the geographical and other limitations on the application of a model, product or service, which can lead to important drawbacks. For example, a model may not be applicable to the markets and needs of beneficiaries in the project area; it may not work with the net income flows in the project environment; or it may be at odds with regulations in the country.

Box 4: Ethiopia's Rural Financial Intermediation Programme

In Ethiopia, access to financial services is a major constraint to the development of rural areas and is one of the critical factors addressed by the government through its Growth and Transformation Plan (GTP). IFAD has been supporting the government's flagship Rural Financial Intermediation Programme (RUFIP), launched in 2003 and currently in its second phase (2012-2019). The programme's objective is to increase sustainable access to a range of financial services for poor, rural, agricultural households, through capacity-building of inclusive FSPs. The FSPs are expected to play a key role in improving financial access for excluded rural populations and in mobilizing the huge savings required to finance investments and meet the strategic objectives of the GTP. The target is to scale up from the baseline of about 3.3 million poor rural households at the end of RUFIP I to reach 6.9 million by the end of RUFIP II. It has become evident that the financial inclusion agenda is far greater than the resources available under RUFIP II.

To address this challenge, the government and IFAD have initiated expanded partnerships with other United Nations (UN) agencies – the International Labour Organization (ILO) and the United Nations Capital Development Fund (UNCDF) – and developed a project to supplement RUFIP II. The government and IFAD understand that development and implementation of a number of the enablers that contribute directly to the strategic objectives and efficient implementation of RUFIP will require the capabilities and technical resources of these additional partners. Besides the supplementary project together with ILO and UNCDF, all UN Country Team (UNCT) members committed to financial inclusion and prepared to make technical and financial contributions are considered active partners in developing new products (micro insurance, lease financing, etc.), new delivery channels (branchless and agent banking, mobile money, etc.), client-centred programmes (women's economic empowerment, financial education, etc.), integrated value chain models (linking MFIs/SACCOs to information technology platforms and transactional services of banks) and management instruments (financial access diagnostics, information and communications technology, data and reporting systems for MFIs and SACCOs, etc.). As well as government agencies and UNCT members, the UN Secretary-General's Special Advocate for Inclusive Finance for Development, the Rome-based agencies' cooperation for food security initiative, development partners, private-sector companies (e.g. Rabobank), NGOs (Terrafina Microfinance) and industry (twinning) partners (e.g. the Irish League of Credit Unions' International Development Foundation) also contribute to scaling up of RUFIP II outcomes and complementary innovations that support the national financial inclusion agenda.

Key drivers and spaces for scaling up

Almost all successful RF interventions supported by IFAD will eventually need to be driven by the private sector. Improved access to financial services continues to reduce not only the economic but also the social exclusion of the millions of rural low-income households in IFAD partner countries. Regardless of whether a country is developing, middle-income, post-crisis or fragile, by providing access to an increasing range of financial services, the finance industry is the main driver of rural economic development, employment promotion, income generation, reduced vulnerability and more sustainable livelihoods. In a vibrant rural financial market, the microfinance industry can have a wide – but financially and operationally sustainable – outreach of products and services offered by banks, MFIs, insurance companies (for micro insurance, including index-based insurance products), money transfer operators (for remittances), mobile phone companies (for digital finance and mobile banking) and leasing and equity companies. Donors and public agents can drive the process only up to a certain point but they can also encourage the private sector to take over and assume the lead by providing an enabling environment, developing essential support infrastructure for the financial sector and working on public goods to help develop and advance the market. If private-sector finance institutions do not step in, inclusive rural financial services cannot be scaled up. As IFAD-supported interventions mature and are evaluated, lessons will emerge regarding the point at which the shift from IFAD-facilitated to private-sector-driven development should occur. To implement and scale up results of inclusive rural financial services projects, favourable conditions need to exist or be created, opportunities should be taken and obstacles addressed. Based on IFAD-wide experience, the key elements to consider are as outlined in the following paragraphs.

Each pathway for scaling up needs to develop and nurture "spaces" where the scaling up can take place.

Market space. It is particularly important to ensure that the market space continues to function and mature as the RF agenda evolves. As described in the previous paragraph, vibrant financial markets foster the development of a range of market-oriented RF institutions, which can contribute significantly to rural development. On the other hand, undue concentration of markets can lead to saturation and over-indebtedness. Pathways for scaling up need to monitor this risk so that policy interventions can be undertaken or market diversification supported as needed.

For IFAD's mandate, it is important that the target market for an RF intervention be clearly defined. This definition can be based on market data and should be consistent with the overall goal and development objective of the project. There must also be clear evidence that the project has sufficient scale to support sustainable outcomes. However, given the limited resources and capacity available, IFAD must also be careful not to overextend the scale of an intervention. Defining the scale and scope of any intervention – national, regional or local – is an important step in determining the potential sustainability of the project. IFAD-supported projects typically focus on certain regions or districts. However, interventions that need critical mass to be operationally and financially sustainable are often targeted too specifically to introduce sustainable financial services; FSPs cannot break even with such low volumes and high costs. Scale has been especially problematic in multisector projects where lines of credit are used as an input to meet other agricultural development objectives. The volume of client demand must be large enough to attract a supplier willing to provide services on a sustainable basis. This requires intelligent programming in rural areas, which are typically hard to reach and home to dispersed populations. IFAD needs to keep in mind that sustainable FSPs typically serve diverse clients in different areas with a wide range of products so the challenge is often more about encouraging stronger institutions to expand downstream, innovations in delivery channels and value chain financing, and demand-led product design rather than artificially creating access where it will not be sustainable when the project ends.

The nature and scale of market demand are often defined by the area's geography or predominant agricultural activities. These two considerations will strongly influence whether an FSP is interested in serving a market and able to do so sustainably. For example, if the market is too small or the population density too low to generate low transaction costs, service providers may not be able to offer profitable, and thus sustainable, services. If there are major risks resulting from the climate or main commodity markets in an area, lenders may be hesitant to serve smallholder households in that market.

Institutional space. Donor support in RF is required mainly to strengthen the delivery capacity of FSPs in rural areas and to upgrade non-formal institutions to higher legal forms, as necessary. Provision of training and consultancy services, improvement of professional standards and purchase of operating assets all constitute forms of subsidy. While IFAD supports a wide range of capacity development activities for RF institutions, interventions should not reinforce aid dependency but instead should lead to the autonomy of the partner institution. IFAD does not have to create all the institutional space itself and should focus its institution-building efforts on areas where it has core expertise and comparative advantages over other partners. Support to community-based financial organizations – including decentralized village microfinance systems, credit cooperatives and their associations and rural banks and their apexes – is an area where IFAD has a long record. Many new areas of institution-building are covered under ongoing projects addressing the demand for a wider range of services and innovative delivery mechanisms. IFAD and other partners are encouraged to be more selective and operate in partnership to avoid redundant replication. One new area of emphasis for institution-building partners is the establishment of monitoring and reporting systems on the financial and social performance of interventions. Institution-building is needed to create this capacity.

Financial space. IFAD has extensive experience in helping small-scale producers, agroprocessors and other off-farm microenterprises and small businesses to gain access to finance. Developing financial space is almost always a major focus of rural livelihood projects, particularly those focusing on value chain development. IFAD operates through various types of FSP, savings and credit products and delivery channels to reach the very poor. While many of these programmes experience problems when operating at larger scales – as they operate mainly without adequate oversight and financial knowledge – IFAD is well positioned to work with government and other partners on reforming and strengthening the system. Access to finance is imperative for smallholder farmers to become effective players in value chain arrangements. New production technologies, infrastructure (irrigation, etc.) and investments in special facilities (warehouses, etc.) are often required for developing from loose value chains to tight, long-term arrangements. However, public finance and the fiscal space in many countries do not allow full grants or matching grant models (grants blended with equity or loans) beyond the life cycle of a project. IFAD's new focus is on the development of value chain financing instruments. More recently, the warehouse receipt programme has become a prominent example of an effective financial space for scaling up in several ongoing projects.

Social space. It is particularly important to create social space. The inclusion of poor rural people – particularly women and youth, and households that are obtaining access to formal financial services and developing long-term relationships with banks – is a major agenda. Women are at particular risk of exclusion from the pathway for scaling up. Inclusion of women is difficult, as women typically lack access to bank-worthy collateral, certified assets and, sometimes, formal education. Often, as income-earning opportunities arise, men take over, such as in contract farming and tight value chains. Exclusion from rural financial services can affect household food and nutrition security, particularly when women are limited to the services of moneylenders or unable to go beyond informal savings and credit self-help groups. As women – and often also youth – are a key target group, IFAD would be expected to focus on these issues but several country programme evaluations are highly critical of IFAD's lack of attention to women and youth in its projects to enhance access to sustainable rural financial services.

Cultural space. Another aspect that is often overlooked are the sociological specificities that may give a model cultural space for scaling up in one part of a country, while making it less likely to succeed in another part where the population has different sociological structures. The example most often cited as exemplifying this point is Nigeria, which has a mixture of strict, hierarchical, traditional Muslim ("purdah") village societies and radically segmented, progressive societies where meritocracy and contributions to the community determine the status and functions of villagers. This diversity may result in projects encouraging groups to save and lend internally when there are cultural prohibitions against interest rates and financial dealings. Women may also be expected to attend group meetings when purdah makes it difficult for them to leave their own premises. Having women participate in a group that is not open to men is another condition that is not always easy to enforce in all parts of a country (Zander, 2012).

Monitoring and evaluation (M&E)

M&E has not yet led to risk reduction and knowledge generation based on the weaknesses found through project-based M&E.

Learning space needs to be proactively fostered by all stakeholders. This fostering involves establishing good baselines, understanding the key deliverables and implementing an M&E system that supports a results-based project management framework. IFAD's operations have applied many different ways of fostering learning and the identification of scalable models. In China, the M&E system for IFAD projects was systematically updated. In sub-Saharan Africa, the IFAD-financed grant programme Rural Finance Knowledge Management Partnership (see: http://www.ruralfinancenetwork.org/) is combining capacity support, knowledge management and research based on IFAD's experience in emerging inclusive RF in the region.

Successful inclusive RF projects will have robust M&E systems that can track the performance of FSPs and identify areas that need added attention. IFAD measures performance in terms of the extent to which FSPs or delivery mechanisms reach their target markets (depth), the number of clients they serve (scale) and the degree to which they do so equitably and sustainably. Designing the framework for performance monitoring and M&E involves several steps:

- define the purpose and scope of the M&E system and the information and outputs expected
- provide a general description of key stakeholder audiences (e.g. the Project Management Unit, IFAD headquarters) and the types of performance information that each expects to receive, when the information is required, the format for presenting it and who is responsible for collecting it
- define the performance indicators to be collected and analysed for each stakeholder audience
- outline the conditions and capacities required to manage M&E, including the number of M&E staff, their responsibilities and linkages to other management activities, and incentives
- develop a budget for M&E activities
- define the steps to be taken if an FSP participating in the programme fails to meet the established performance criteria over a given period; IFAD should be in a position to stop supporting implementing partners that are not meeting performance expectations (according to a performance-based contract) (IFAD, 2014).

Managing scalability becomes a bigger challenge after an IFAD project is completed. In Indonesia, where a flexible legal and supervisory framework for microfinance has enabled plenty of experimentation, appropriate management of scaling up constituted a challenge to the IFAD-supported Income-Generating Project for Marginal Farmers and Landless in Indonesia (P4K) (Zander, 2012).

Key messages

To be effective in scaling up approaches for RF, IFAD would benefit from more flexible instruments for acting on the lessons and recommendations in this note:

- Analysis of IFAD by Linn et al. observed that the Fund should consider expanding the rather limited instrument mix in its current business model and exploring elements of a new model that supports and focuses on the scaling-up agenda. To this end, business processes, available instruments and positioning in the market vis-á-vis other public- and newly emerging private-sector and philanthropic agencies should be explored. The project perspective needs to be augmented by a focus on development pathways for successful approaches once these have been identified and are robust enough for scaling up.
- Promoting innovations in inclusive RF has also been held back by the lack of a more diversified set of instruments for IFAD. Even loans and grants have so far not been adequately calibrated to the needs of an innovation agenda. In its lending portfolio, IFAD has none of the specific instruments for promoting innovations that other international financial institutions have (e.g. the World Bank's small innovation loans). It uses the instruments at its disposal to discharge its mandate for promoting innovations (e.g. loans, grants, M&E,

partnerships, policy dialogue, etc.). Each instrument has its own strengths and potential in this respect, along with weaknesses that need to be addressed. With no explicit strategic approach to innovation or adequate internalization of the innovation process, IFAD loans have promoted innovations on a sporadic and case-by-case basis. Technical assistance grants have a role in identifying and testing innovations for adaptation and promotion by projects but this role has yet to be fully developed. In the meantime, at the global portfolio level, IFAD has an important role in developing innovative public goods that can be taken up by the financial industry as a whole, as well as by IFAD's interventions (e.g. work on agricultural insurance and remittances). Up to now, IFAD loan funds have been strictly tied to activities based on project cycles. Scaling up would be facilitated by having the ability to finance scouting or support activities outside the project cycle. Such support could be based on a review of IFAD-initiated models that have been scaled up by governments or other development agencies. Fund recipients could also include private-sector agencies, preferably those representing IFAD's target clientele at the grass-roots level (producer federations, cooperative apexes, national umbrella organizations of community-based financial institutions). The longer-term nature of scaling-up activities and the associated institution-building may be addressed through lengthening the term structure of standard IFAD loans and thus the length of IFAD-financed projects and programmes. Grant funds for project implementation, which constitute a major part of the instrument mix of other international financial institutions, have been available to IFAD's operations to only a limited extent. Use of larger grants for activities that support the scaling-up agenda has only recently been accelerated.

- Scaling up of activities for inclusive RF could be supported through a different and more varied set of instruments. The precise nature of the instruments, such as investments in or partnership with the private sector, needs to be guided by a strategy and IFAD needs to reach concrete objectives at the highest level of its governance. Equity financing instruments – either on a stand-alone basis or through a structured investment fund or syndication – should be made available through IFAD, particularly as the presence of country offices makes it possible to carry out quick on-site exploration, board representation and follow up. Private-sector lending should include an option for syndicated lending, which may be useful for supporting novel and unusual activities that are not financially attractive to development agencies and commercial channels. In a dynamic international donor environment with competition evolving on the supply side and more diversified demands from recipient countries, the mix of available instruments needs to be broadened and IFAD's operating model needs to be adjusted to create a more conducive environment for initial experimentation and innovation, structured learning and scaling up later on.
- IFAD-supported RF interventions need to define a clear exit strategy as part of project design: an exit strategy is a plan that allows the project to replicate in other areas, scale up in the project area or disengage from partner implementing institutions, leaving them in a position in which they can continue sustainable operations without further inputs from donors. In implementation, institutional development programmes should have incentives for building internal capacity and reducing dependency, while training and technical assistance costs are integrated into the institution's budget over time.

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