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AFIRMA ANNUAL REPORT

PROJECT YEAR 2

October 2005 – September 2006



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The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

Cover photos: Clockwise from left, Fondo 5 de Mayo client Cecilio Flores, Puebla (by Phillips Bourns), AISol clients in Chamula, Chiapas (by Nathanael Bourns), FinComún client Maria Teresa Perez, Tepito Market, Mexico City, (by Juan Ahedo), AFIRMA Rural and Agricultural Finance Workshop (by Christian Penotti)

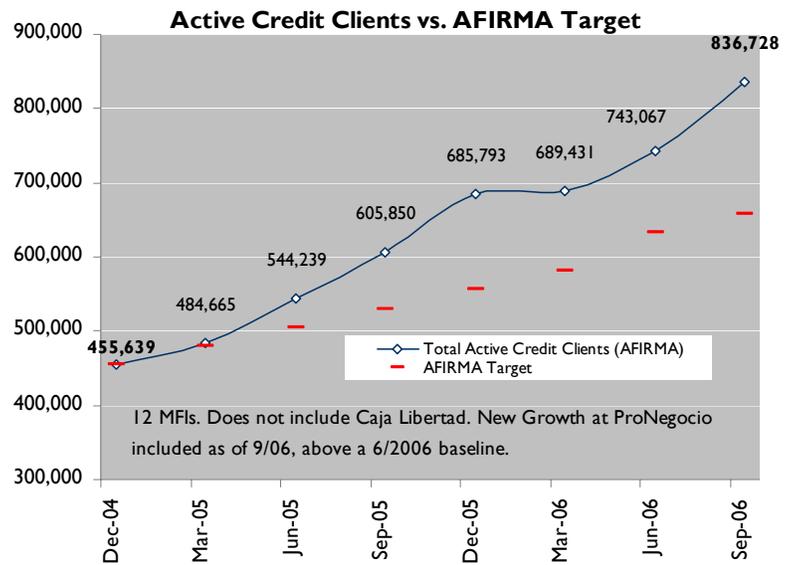
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I. EXECUTIVE SUMMARY

The USAID-funded AFIRMA Project, implemented by DAI, is designed to help build an inclusive, sustainable microfinance sector in Mexico as a means to increase access to a range of financial services and contribute to local economic development. Year 2 results included:

- Task 1: Strengthen MFI capacity.** AFIRMA continued work with a diverse range of 13 partner microfinance institutions (MFIs). Partners improved their financial performance and services, and are now reaching a total of 836,728 clients, an increase of 353,769 above the December 2004 baseline. Following slow growth in early 2006 partners grew rapidly as the year progressed, having (to varying degrees) improved management, systems, human resource processes and training, and having increased access to lending capital. In addition to building various aspects of internal capacity, depending on the need of each partner, AFIRMA has now supported re-design or development of 9 financial products, in an effort to help partners better meet client needs.



- Task 2: Develop a local, commercially-based MFI support services industry.** As a first step in building the human resource base for microfinance, AFIRMA designed and delivered an introductory microfinance course with the National Polytechnic Institute (IPN), and is building upon classroom instruction with practical field experience in connection with AFIRMA's partner MFIs. The initiative attained very high marks with IPN students and professors, as well as with leaders from the sector who volunteered their time to the effort. The project also has increased its use and development of local firms and consultants, working in close coordination with project staff and specialists.
- Task 3: Support innovations to expand access to rural finance.** AFIRMA worked with USAID Development Finance Advisor Geoffrey Chalmers to adjust and deliver USAID's Rural and Agricultural Finance Workshop to local representatives of financial institutions serving, or planning to serve, rural and small-scale agricultural clients. The workshop marked the launch of this task and informed the design of an innovation grant fund to be launched in early 2007.
- Task 4: Build capacity to supervise microfinance.** AFIRMA was in regular contact with new leadership for implementation of the Popular Savings and Credit Law at the Banking Commission (CNBV) during the year, and took a group of supervisors to study experiences in Peru and Ecuador.
- Task 5: Improve the enabling environment for rural and microfinance.** AFIRMA worked in partnership with the Central Bank to examine options in expanding credit information services in Mexico, and with a private credit bureau, to design a product specifically for MFIs. AFIRMA also assisted the *Secretaria de la Economia* to plan the 5th National Microfinance Encounter, at which USAID Mission Director Edward Kadunc presented the Mission's microfinance initiatives.

2. INTRODUCTION

The Access to Rural Finance for the Microenterprise (AFIRMA) Project, a USAID-funded project implemented by Development Alternatives, Inc. (DAI), forms a central part of USAID/Mexico's Results Framework, under the new regional Strategic Objective (SO2) for Central America and Mexico: **Economic Freedom: Open, Diversified Expanding Economies**. Under SO2, AFIRMA contributes to Intermediate Result 3: **Broader access to financial markets and services**, and the project's primary goal can be summarized as:

Contribute to the development of a dynamic, effective microfinance sector in Mexico that provides sustainable financial services to under-served urban and rural market segments, helping them manage risk and contribute to local economic growth.

The AFIRMA Year Two Work Plan outlined five interrelated tasks:

1. Strengthen the institutional capacity of MFIs;
2. Develop a local, commercially-based MFI support services industry;
3. Develop innovative products and technologies that expand access to rural financial services and remittances;
4. Strengthen the capacity of the CNBV and federation committees to supervise popular finance;
5. Improve the enabling environment for the rural and microfinance industry.

These tasks, their relationship to one another and to the project goals are outlined in the Performance Monitoring Plan, updated in January 2006 to meet the Mission's new strategic objectives and intermediate results. Progress towards each task during Year 2 (October 2005-September 2006) and key priorities for next year are presented in the next section, followed by a brief description of project management, including a summary of project finances.

3. AFIRMA WORK PLAN IMPLEMENTATION

3.1 TASK I – STRENGTHEN MFI INSTITUTIONAL CAPACITY

To support increased outreach, AFIRMA seeks a balance between the breadth of outreach, in terms of the number of new clients served, and the depth of outreach, in terms of the poverty level and geographic location of clients. The project strategy to work with institutions of different types, sizes and target markets, and the diverse institutional development needs of these institutions, illustrate potential trade-offs between achieving the greatest number of new clients with access to service (project goal is 500,000) and working with poorer and rural clients, where total growth may be slower and where institutions may require substantial capacity-building before emphasizing growth. Beyond overall growth, in prioritizing

Core principles of AFIRMA support of Partners

- **Respond to well-thought-out business plans**, owned by partners, addressing needs and capacity for sound growth and sustainability.
- **Demand-based approach** – respond proactively to the needs of each partner within the framework of business plans and project objectives,
- **Maintain flexibility** to respond to the changing market conditions and partner needs.
- AFIRMA consultants are **facilitators of change**, but partners themselves take ownership of the processes and changes.
- **Continue support based on results**, responsiveness, openness to change, and capacity to absorb assistance.

assistance, AFIRMA also considers factors such as geographic market, marginalization of target clientele and outreach in terms of providing financial services to the most difficult-to-serve markets.

In early 2006 AFIRMA began using the project's standardized monitoring system to produce in-depth financial and operational performance reports for partners MFIs showing interest in the feedback. The response was highly positive and following consultations with USAID, the project will continue this effort. Given the additional workload that this effort represents, it will require additional staff support, and along with USAID, AFIRMA has identified 2 local junior consultants to support this effort, one based at, and reporting to, the MFI association ProDesarrollo, and another working directly with AFIRMA.

Below are highlights of AFIRMA support for each partner over the year and key objectives for next year. **A summary of performance indicators as of September 2006 is presented in Annex A.**

3.1.1 FIMEDER

FIMEDER, now operating as a regulated Popular Finance Society (SFP) attained profitability last quarter, while continuing to grow and expand its services. Notably, FIMEDER has added a savings product, which it will work to expand in 2007. Project support to FIMEDER during the year included:

- **Board of Directors Study Tour** – AFIRMA Senior Microfinance Specialist Willy Escobedo took FIMEDER Board President Jesús Villaseñor, Vice President Miguel Mancera¹ and two other board members to Ecuador and Peru to visit successful MFIs. The group visited the USAID-funded SALTO Project (implemented by DAI) Banco Procredit, and Banco Pichincha. In Peru, the group visited MiBanco, Caja Rural del Sur, Caja de Municipal de Arequipa, Edpyme Crear, and Nueva Visión. The trip allowed the board to focus on FIMEDER, and to develop new perspectives on the potential of sustainable microfinance.
- **Strategic Planning** – AFIRMA consultant Max Errazuriz worked with FIMEDER to develop a strategic plan for 2006-2010, as well as the operational plan and budget for 2006, all of which the FIMEDER board of directors approved.
- **Training in Marketing and Sales for microfinance** – Mauricio Lerner, Peruvian microfinance marketing and training specialist, trained trainers and FIMEDER loan officers in tools for improving sales techniques for microfinance. Mr. Lerner created an instructor's manual for the sales courses he gave so that FIMEDER can replicate the training in the future.
- **Adjusted Individual Loan Pilot Product** – Peruvian microfinance operational specialist Vicente Avalos supported FIMEDER with refinements and piloting of the adjusted individual loan product.
- **Savings Product** – Willy Escobedo assisted FIMEDER management in defining the following elements of its savings mobilization strategy: marketing, pricing, and operational and human resource considerations. As a regulated entity, it has added a savings service and opened its first savings account during the second quarter of 2006.
- **Development of the "FIMEDER School" human resources and training program** – Last quarter, Bolivian consultant Eliana Otondo began working with FIMEDER to solidify this project,

¹ FIMEDER's Board includes recognized Mexican business leaders, and in the case of Mr. Mancera, the former president of Banco de México

a priority long-term activity for the company, and will continue into 2007 given the positive initial response of FIMEDER management.

Upcoming priorities that AFIRMA has identified with FIMEDER are:

- Continued support of the FIMEDER School initiative (Eliana Otondo)
- Training on taking savings products to scale (Mauricio Lerner)
- Present the AFIRMA institutional report to Management and the Board of Directors, at the request of management (Nate Bourns and Fernando Fernandez)
- Analysis of back-office and operational IT needs (TBD)

3.1.2 AISol

AISol began 2006 attaining profitability for the first time in its 6-year history, but with limited liquidity to expand lending. AFIRMA advocated on behalf of AISol with funds and investors interested in investing in the institution's sustainable growth and the institution since opened a line of credit with FINAFIM (Secretary of the Economy), had met with various international microfinance investors, and obtained a capital donation of \$400,000 (nearly doubling the institution's equity base) through the *Central America and Mexico Hurricane Relief Fund*, funded by US-based corporations Pepsi, John Deere, American Electrical Power, and Asset Management Advisors (AISol was referred by USAID/Mexico). AISol also was selected to receive an EM-DAP advisor, and Ana Luisa Pinto Sanchez began her 9-month assignment with the institution in September.

In addition to the activities mentioned above, during the year AFIRMA supported the following initiatives:

- **Strategic and operational planning** – Reuben Summerlin supported AISol's strategic and operational planning and supported a reorganization led by AISol management and based on newly-defined priorities. Mr. Summerlin worked with the board of directors to re-think its role and level of commitment. This was the first time AISol conducted a complete business planning process, the institution gave high priority to the process, and Mr. Summerlin was subsequently brought in to support plan implementation.
- **Operational adjustments** – Mr. Summerlin also reviewed AISol's operations, indicating need for greater internal controls, and made specific recommendations to improve controls and focus activities on the core business. He will continue to work with AISol into late 2006, working closely with the new Manager of Financial Services (operations) to continue with operational adjustments.
- **Internal Control System** – Following Mr. Summerlin's initial review, AFIRMA's Internal Controls consultant Alejandro Guevara worked with the management team at AISol, including the newly hired internal auditor, to develop a set of manuals and system of internal controls to permit continued growth based upon improved controls.
- **Board of Directors Training** – In April 2006 AFIRMA staff Fernando Fernandez, Nate Bourns and Claudette Martinez developed and delivered a 1-day training course for the AISol Board on the role of boards and best practices in MFI governance. The course was followed by a half-day course for all AISol staff.

- **Analysis of the Legal and Fiscal Structure** – AFIRMA cost-shared with AISol a contract with the local accounting and legal firm, **ESFI Consultores** to analyze the appropriate future capital and legal structure for AISol given its plans.

Upcoming priorities that AFIRMA has identified with AISol are:

- Evaluation of needs and options for a new management information system
- Creation of a Human Resources function within the Administrative area and training on human resources management.

AFIRMA will work with AISol in late 2006 to identify other areas for support based on AISol's plans for 2007.

3.1.3 DESPENO

Despeno improved performance significantly in late 2006, following a difficult stretch as it continues a transition begun in 2005 from a dedicated “distributor” of funds from FIRA (the GoM fund for agricultural lending) to a more traditional MFI with continued interest in serving rural clients. During the year, AFIRMA assistance focused on the following activities:

- **Strategic Planning** – As part of the TA program, AFIRMA assisted with the adjustment of Despeno's Strategic Plan, facilitated by DAI consultant Ignacio Estevez, who helped Despeno develop its main goals and projections.
- **Adjustments and re-launch of the credit product** – In late 2005 DAI microfinance specialist Claudia Ordóñez, focused on methodological adjustments and conducting a full pilot program for the adjusted solidarity lending product and accompanying credit manual.
- **Training and Human Resources** – Building upon efforts to improve the credit product and methodology, human resource specialist Eliana Otondo re-designed the approach to human resource management, with emphasis on recruitment, selection, orientation and training of loan officers (changing the prior arrangement of using independent contractors as loan officers), and delivered training for 20 branch office employees. Ms. Otondo returned later in the year to strengthen HR procedures, in particular selection, induction, and training, an effort that will continue into next quarter.
- **Management Information Systems** – AFIRMA Consultant Carlos Paredes worked, along with local junior consultant Omar Flores (linked to task 2), with Despeno to determine needs for a new management information system (MIS).
- **Position Profiles** – Willy Escobedo assisted Despeno in developing profiles for the General Manager and Credit Officer positions.
- **Individual loan product** –Pablo Alborta, an individual microfinance lending specialist, has assisted with the development of the individual loan product, one of Despeno's priorities. Mr. Alborta's work will continue into 2007, as he focuses increasingly on building Despeno's internal team and operational capacity.

Upcoming Priorities for AFIRMA support of Despeno include:

- Ongoing monitoring and follow-up assistance with the adjusted solidarity group loan product and the new individual loan product (P. Alborta)
- Human resources follow-on work (E. Otondo)
- Review of options and governance for future growth (A. Silva)
- Operations management improvements (H. Sánchez)
- Deliver Operational Training on sales of intangible products to Despeno loan officers (Lerner)

3.1.4 CADEMI

In 2005, CADEMI grew well in terms of total active credit clients, but has slowed slightly in 2006 and increasing operating costs relative to the loan portfolio, drove down profitability. During the year AFIRMA focused on 3 new technical assistance initiatives with CADEMI:

- **Credit Product and Methodology Refinements** – In November 2005 Ramiro Carrasco of AFIRMA subcontractor Quisqueya, began work revising and adjusting CADEMI's the group lending methodology. Mr. Carrasco analyzed the product and recommended adjustments.
- **Human Resources** – Eliana Otondo conducted a diagnostic of HR functions and developed a detailed plan to improve the selection, recruitment and training of loan officers.
- **Review of tax status** – In December 2005, through a purchase order with the local tax and accounting firm Anjona, AFIRMA helped CADEMI analyze their tributary and legal situation as a non-profit NGO (*Asociacion Civil*), a necessary step in CADEMI's plans to transform to another legal status (potentially a regulated finance company). The report revealed that CADEMI had significant pending tax liabilities. Following review of the report with USAID, AFIRMA sent a letter to CADEMI indicating that the project's program would be suspended until the tax situation was resolved.

Based on the last point, AFIRMA assistance to CADEMI was on hold for much of the last 3 quarters. Having clarified the situation, and following a review by the local tax and accounting firm *Desarrollo Empresarial Anjona*, AFIRMA is working with CADEMI to determine priority areas for assistance, the first of which will be supporting system implantation, to support adjustment/development loan products.

3.1.5 AMUCSS

AFIRMA work with AMUCSS during the year focused heavily on improving accounting and information systems, and supporting planning for the future of the network. The AMUCSS network grew more slowly over the past 12 months than other AFIRMA partners, but AMUCSS was in the process of taking important steps to improve the flow and quality of management information within the network, and at individual *microbancos* to support management decision-making and regulatory compliance with the Popular Savings and Credit Law (*Ley de Ahorro y Credito Popular - LACP*). Specific areas of support during the year included:

- **Accounting, Internal Control and Initial LACP Compliance** - First on the list of priorities with AMUCSS was the need to establish reliable accounting and internal control systems. Rafael Tejada of AFIRMA subcontractor Quisqueya Finance worked with local internal control specialist Martín Yedra to improve accounting and control systems, and produce reports

previously unavailable to management. Initial progress permitted AMUCSS to affiliate with the FEDRURAL Supervisory Federation² and request an extension for legal conversion to a regulated entity, an obligatory step under the LACP since AMUCSS mobilizes voluntary savings. Assistance therefore fulfilled a high-priority objective, allowing the *Redes de Microbancos* to continue operating legally. AMUCSS has since hired Mr. Yedra directly. AMUCSS has now produced, for the first time in its history, financial statements for March and June, 2006 for all *Redes de Microbancos*.

- **Management Information System** – In parallel with the accounting work described above, AFIRMA supported, through a cost-shared contract with Consultants in Tecnologia Integral, S.A. (CTI), implementation of the Rana management information system (MIS). AFIRMA has also sponsored training on managing the software so that AMUCSS is not bound to the software provider for every adjustment. Local systems consultant Omar Flores provided additional support in continuing to implement and adjust accounting and portfolio management reports.
- **Strategic Planning and definition of the organizational structure** – As an important part of determining an overall direction and sustainable organizational structure for AMUCSS, DAI Senior Microfinance Specialist John Magill facilitated the planning process for 2006-2008. Mr. Magill facilitated a planning meeting with the managers of the networks of micro-banks, co-financed with Financiera Rural. The meeting resulted in the formation of 2 internal commissions: one to analyze options for the ideal legal and organizational structure of AMUCSS, and the other to focus on improving the financial position of AMUCSS. Although the long-term strategy is yet to be fully defined, AFIRMA assistance started a process that will continue.
- **Regular meetings with AMUCSS Management** – AFIRMA and USAID, in coordination with the Ford Foundation (which has supported AMUCSS) dedicated significant time to regular with AMUCSS leadership in order to define needs and priorities in terms of governance, accounting, MIS, credit products, portfolio quality issues, and internal controls.

Future support of AMUCSS will be coordinated with the Ford Foundation and conditioned based on a clear definition of the institution's situation and priorities. Likely areas for further assistance are:

- Human resource management
- Ongoing support to improve Internal controls and accounting
- Support with credit operations

3.1.6 Fondo 5 de Mayo

In late 2005, Fondo 5 de Mayo (F5M) broke from a past of conservative growth, setting a trajectory of rapid growth, while maintaining profitability. Due to the growth, F5M confronted liquidity challenges in mid 2006, and AFIRMA supported F5M to examine options for capitalizing the lending operations. During the year AFIRMA provided the following support to F5M:

- **Lending methodology Adjustments** – DAI Microfinance Specialist Robin Young worked with F5M management and operational staff to adjust the solidarity group methodology and finalize the credit manual and accompanying documentation.

² FedRural has been approved for delegated supervision under the *Ley de Ahorro y Credito Popular* (LACP – Popular Savings and Credit Law).

- **Strategic and business planning** – Senior microfinance specialist Alex Silva, worked along with Robin Young to help the F5M president and senior management set the institution’s future course. Ms. Young coordinated with F5M to develop operational plans, and financial projections. Mr. Silva’s perspective helped F5M conduct a critical analysis of all of options open to the institution.
- **Operational Staff Training** – Resident technical advisor Hector Cisneros of El Salvador provided constant high-quality support in implementing the F5M plans. Mr. Cisneros has, among other tasks, trained operational staff in the adjusted credit methodology and improved the process of identification, orientation and training of loan officers.
- **Individual Lending Product** – Based on progress begun with the adjustments to the solidarity group lending methodology, Robin Young began working with F5M to develop an individual lending product. Also, Willy Escobedo and Mr. Cisneros have both supported this effort through branch manager and loan officer training, pilot-testing, revision of credit manuals, and product roll-out.
- **Individual Lending Study Tour** – Ten high-performing branch managers and loan officers visited Banco Procredit in El Salvador and Caja Municipal Trujillo to further their knowledge of individual loan technology.
- **Support to Identify Funding Sources** – Nate Bourns worked with F5M to identify sources of short- and longer-term funding, including ProFund, Acción Internacional, the Microfinance Funds of Deutsche Bank in New York, and Cyrano (manager of the LA-CIF fund).

F5M continues to be on-target with aggressive plans for 2006. F5M management and board of directors have identified the need to examine options for transformation in order to obtain the capital necessary to sustain lending operations growth. Future priorities for support include:

- Review and adjust individual lending product (Robin Young, Willy Escobedo)
- Expansion of the individual lending product (Hector Cisneros)
- Valuation of the F5M lending operations (TBD)
- Support decisions on transformation of the lending operations to a regulated entity and Governance (Alex Silva, Nate Bourns)
- Define needs and options for a new management information system, depending on strategic decisions for transformation (Gabor Simon)

3.1.7 ProMujer Mexico

ProMujer Mexico (PMM) focused heavily on internal changes during the year, as it transitioned to a new management, and continued to develop profitably. Similar to other AFIRMA partners, PMM also faced the need for increased lending capital to grow more aggressively, and has successfully expanded its sources of funding. Despite internal changes and challenges related to systems and control problems, PMM managed to improve performance significantly in late 2005 and continued positive trends towards improvement in financial and outreach results into late 2006.

During the year, work with ProMujer focused on the following:

- **Market Study** - DAI consultants Hillary Miller-Wise and Brooke Jones, worked with the local research firm, Serta (hired under a cost-shared purchase order), to carry out a market study. ProMujer was pleased with the quality of the deliverable and In January 2006, Ms. Miller-Wise presented the market analysis to ProMujer management, president and to USAID, and completed a written marketing strategy. Although not included in the SOW for this support, advice from Ms. Miller-Wise was instrumental in adjusting PMM's loan product to increase on-going demand for the service and eliminate counterproductive repayment incentives, which contributed to positive financial trends.
- **Internal Control and Decentralization** – Peruvian microfinance consultant Leopoldo de la Jara and local consultant María Olazábal supported PMM to establish internal controls and a more appropriate structure given PMM's strategy of operational decentralization. The consultants completed a full set of manuals, the final of which (credit manual), is currently undergoing final adjustments following feedback from PMM President.
- **Management Information System** – Identifying and implementing a new MIS was a top priority for the new management (and an area AFIRMA had identified from the beginning of the project), given problems faced in 2005. At the request of the systems committee of the PMM board of directors, Gabor Simon worked with PMM to facilitate a technical process that involved documenting user requirements, evaluating a shortlist of available software (building on the process begun by ProMujer International), and making recommendations.
- **Strategic planning** – AFIRMA DCOP Nate Bourns participated in ProMujer's strategic planning process in order to give the project's perspective on risks and opportunities that AFIRMA sees for microfinance in general and with PMM specifically, and to ensure that AFIRMA support is directed towards assisting PMM with priority initiatives.

Upcoming Priorities include:

- Contracting MIS and Definition and development of the PMM Systems Area (Gabor Simon)
- Definition and development of a Human Resources Area (Gabor Simon)
- Definition and development of a Marketing Area (Gabor Simon)

3.1.8 FINCA Mexico

Following FINCA Mexico's outstanding performance in 2005 and slowed growth in active clients and in early 2006, FINCA growth picked up last quarter, reaching the 50,000 client mark in late July and closing September with 57,258 clients. AFIRMA provided intensive assistance in response to FINCA's needs during the year:

- **Strengthen the Human Resources Area** – Local consultant Vayda Sosa completed her support of FINCA's human resources strategy, including a module of the training program for middle managers.
- **FINCA University** –AFIRMA Training Specialist Claudette Martinez worked in coordination with then USAID-sponsored Advisor Ivana Fertziger to design a training program for middle managers, which launched the FINCA University project (with FINCA Mexico being the pilot for FINCA International). This first program, delivered by this training unit, will be held from July 2006 to April 2007, through internal and external consultants supported by AFIRMA.

- **Operations Support** – Johnny Velasco, a microfinance operations specialist from Bolivia continued his one-year scope of work as Resident Consultant. Mr. Velasco has focused on supporting FINCA in consolidating the operational area, improving operational efficiency and client retention.
- **Systematization of Administrative Procedures** – The local firm SIN, (*Servicios Internacionales de Negocios*) led Felipe Sandoval, completed its work with FINCA, resulting in the development of a set of manuals documenting and systematizing each of FINCA Mexico’s operational processes, and training personnel on how to use and update the new manuals.
- **Management Information Systems** – AFIRMA continued to support analysis of the capability of the MIS, SIEM 7, to adapt to the administration and control necessary for the planned expansion. IT consultant Carlos Paredes, with support from local IT consultant Omar Flores, worked with FINCA Mexico to determine communication, control systems and data transmission requirements, and worked to improve overall information security measures. FINCA made strong progress implementing new security measures.
- **Problem loan recovery** – AFIRMA Senior Microfinance Specialist Willy Escobedo concluded his support of FINCA operational staff to diagnose and address rising loan delinquency. In addition, Mr. Escobedo gave a workshop for branch managers and loan supervisors on branch administration.
- **Individual Loan Product Development and Pilot** – Luis Echarte, a product development specialist from Uruguay, began developing an individual loan product for FINCA in late July, with the cost of the project shared between AFIRMA and FINCA. The product is being refined, a team of loan officers has been hired and is currently being trained, and the pilot will be launched in Cuernavaca, Morelos in late October.
- **Transitional Savings Product Development** – Paraguayan Consultant Estanislao Barrientos began his study to develop a transitory savings product that FINCA can offer clients, both technically and legally, in the interim before transforming to a deposit taking institution. The cost of this project is being shared with FINCA.
- **Regulation Feasibility Study** – Local offices of the law firm Link International conducted a study to determine the legal implications of the different regulatory options available to FINCA as they explore the possibilities for transforming to a deposit taking institution. The cost of this study was shared with FINCA.
- **Study tour for leading field staff** – As FINCA reached the 50,000 client mark in late July, AFIRMA is currently coordinating a study tour for the most productive field staff, to visit leading Bolivian microfinance organizations in January 2007.

AFIRMA and FINCA are in the process of identifying future priorities, likely to include:

- Technical feasibility study of transforming to a regulated MFI
- Development of a risk management department

3.1.9 FinComún

FinComún has grown extremely well in terms of total savings clients following its licensing as a regulated SFP (*Sociedad Financiera Popular*) at the beginning of 2006, although growth in credit clients slowed during the year as the institution focused on operational adjustments related to the primary credit product. AFIRMA continued to meet regularly with FinComún senior management to understand and provide advice on the institution's governance, and operational issues (in particular loan portfolio quality). AFIRMA also supported the following activities over the course of the year:

- **Strategic Planning** – Guatemalan consultant Luis Noel Alfaro supported FinComún's Strategic Planning processes for 2006-2010
- **Product and Methodology Adjustments** – AFIRMA continued to support FinComún with loan product and methodological adjustments through technical assistance from credit specialist Michael Steidl. The work revealed weaknesses in the credit analysis, a main cause of loan delinquency and last quarter AFRIMA and Mr. Steidl implemented a re-training plan for operational personnel, with emphasis on the individual loan product and problem-loan recovery. Mr. Steidl also trained operational staff in credit analysis for individual lending and updated FinComún's training modules for all products.
- **Costing System** – As a means to understand areas for efficiency improvements, the project defined further support in costing, following well-received support from Bolivian microfinance costing specialist Milagros Chiappe. Ms. Chiappe continued to coordinate with FinComún and will return in late 2006 to support full implementation of a costing system.
- **Position Profiles** – Willy Escobedo assisted FinComún in developing profiles for internal and external legal support positions.

FinComún Client Meets EGAT Director



In April 2006, FinComún and AFIRMA hosted a visit from the **USAID/EGAT Director Jacqueline Schafer** to review the institution's progress to date, experience with the project, and to visit Maria Teresa Perez, a seamstress whose business has developed well due in part to loans from FinComún

AFIRMA also facilitated contact with the Banco de Guayaquil, in Ecuador to Exchange experience in the use of palm pilots and cellular technology in microfinance operations. Based upon FinComún's priorities, AFIRMA plans to provide support in the following areas:

- Final implementation of a Costing System in the new MIS (Milagros Chiappe)
- Overall improvement program for training and human resource management, including systematization of training manuals for the commercial department.
- Support of a new project designed to expand on FinComún's strategic alliance with Bimbo to provide loans directly via Bimbo distributors. (Michael Steidl)

3.1.10 CAME

AFIRMA and CAME continued to hold regular meetings in 2006. Although support was less intense, the project held important meetings with members of the board of directors and the General Manager to determine how best to assist CAME through a leadership transition.

- **General Manager Profile** – At the current General Manager’s request AFIRMA contributed a profile a new General Manager for CAME to adjust to its needs.
- **MIS Implementation** – In late 2005 and into 2006, AFIRMA continued to support CAME with implementation of the FINMAS Management Information System through technical assistance from Bolivian systems consultants Miguel Garcia and Rícela Muñoz. Mr. Garcia’s work focused on branch installation of the system, while Ms. Muñoz is currently supporting CAME to finalize the implementation.
- **Microfinance Operations** – CAME requested project assistance with improving the overall functioning of the institution’s operational area, and strategic and operational planning of the growth of the credit portfolio, including growth and productivity goals. For this work, AFIRMA identified Bolivian microfinance expert Liliana Bottega, former Operations manager at *Caja los Andes*, and more recently Women’s World Banking consultant. Ms. Bottega recommended adjustments to the village banking methodology as implemented at CAME, although needed adjustments have yet to be made.
- **Operational cash management** – Willy Escobedo supported CAME’s efforts to implement cash transactions in various branches.

Based upon CAME’s priorities for 2006-2007, AFIRMA plans to support in the following areas:

- Continued support of final full implementation of the FinMas system
- Systematization of operational processes
- Develop individual loan product (longer term)
- Credit operations support, possibly through a resident advisor, depending upon performance in other areas

3.1.11 Caja Libertad

Caja Libertad continued to grow aggressively in its traditional niche, now serving over 286,000 credit clients and over 580,000 savings clients. Work with Caja Libertad to design and launch a microcredit product moved slowly, following delays in internal decision processes.

Assistance to Caja Libertad focused on:

- **Microcredit Product Development** – AFIRMA coordinated with Caja Libertad on the previous design of a microenterprise loan product, and on building internal consensus within the Caja on the implications of a new loan product for the microenterprise segment. The deliverables were reviewed by Caja Libertad’s board and management, which expressed in writing the desire for AFIRMA assistance with a microcredit pilot in late 2006, slated to be launched in January 2007 (along with the T24 MIS from Temenos). The product now has dedicated line in the Caja Libertad budget, which, AFIRMA hopes, will facilitate the process in 2007.

AFIRMA has discussed with Caja Libertad a work plan to conclude at the beginning of 2007 with the launch of the individual microcredit product in three branches. The following additional assistance has been discussed with Caja Libertad:

- Study tour for the main members of the board of directors and senior management to see credit unions that have been successful implementing microcredit products
- Implementation of a risk management area
- Systematization of processes and procedures for the individual lending product

3.1.12 Compartamos

Compartamos was officially licensed as a Bank on June 1, 2006, becoming Mexico's first commercial bank fully-dedicated to microfinance. Following a slow start to 2006, Compartamos grew quickly through the third quarter of 2006, including continued growth in the segments it is reaching (with support from AFIRMA subcontractor Acción International) through its individual and solidarity group loan products, now with over 30,000 active clients for these two products. Despite major investments in human resources and other elements of its expansion, Compartamos maintained its high level of profitability through September 2006.

During the year AFIRMA supported improved capacity for development and adjustment of new products and improved efficiency through assistance led by Acción. The Acción team, led by Monica Brand, Vice President of Marketing and Product Development at Acción, focused during the year on developing internal capacity to develop products and services and on improving overall operational efficiency and productivity.

- **Product Development** – Following successful development of a prototype home improvement loan product, and field monitoring of the basic pilot micro-insurance product, Acción worked with Compartamos to adjust the manuals based upon the pilot experiences with the home improvement loan product and the basic insurance product.
- **Efficiency and Productivity** – Acción Consultant Wilmer Guevara has developed tools and MIS reports necessary to manage individual and solidarity group loans for greater efficiency and productivity, developed credit manuals for individual and solidarity group lending, assisted with restructuring the sales force (including loan officer selection) and developed credit manuals, forms and analysis tools, and incentive structures, and trained staff in these tools. The “Efficiency and Productivity” initiative has contributed to more than doubling the individual and solidarity loan portfolios and increasing loan officer productivity by 50%.

The two activities outlined above will continue into 2007. During the last quarter, AFIRMA, Acción and USAID agreed upon a work plan with Compartamos addressing key priorities through September 2007. Specific areas of support include:

- Continue supporting consolidation of the Efficiency and productivity program (Wilmer Guevara)
- Support pilot and launch of products for housing improvement, insurance, and incorporate new products into the incentives schemes (Monica Brand and Acción Team)
- Brand management as Compartamos begins to offer a wider range of products
- Client retention
- Credit Scoring, focusing primarily on segmenting clientele and examining common characteristics of client desertion (2007)

3.1.13 Creditos ProNegocio

AFIRMA began work with ProNegocio, the finance company (SOFOL) owned by Banorte (the largest Mexican-owned commercial bank) in close coordination with USAID/Mexico, following an in-depth diagnostic conducted in December 2005. ProNegocio agreed in principle to fund half of a technical assistance program with AFIRMA and in mid 2006 the project began supporting ProNegocio, in the following areas:

- **Branch Evaluation** – AFIRMA’s support to ProNegocios initiated with an evaluation of branches in Monterrey, their internal politics, client growth, credit operations, and collections processes, among other key elements, conducted by Willy Escobedo and Robin Young.

AFIRMA and Pronegocio have discussed the following additional topics for assistance:

- Strengthen the credit technology and develop new products for the microenterprise segment (Willy Escobedo)
- Revise the organizational structure, human resource policies, and develop a training program (Robin Young)
- Develop specialized risk management, including internal audit for microcredit operations.
- Improve the marketing strategy, including market intelligence, and promotional campaigns.
- Expose directors to microfinance best practices and benchmarks and train directors and managers in planning and management techniques for successful microfinance operations.

Ambassador Garza Launches USAID Technical Assistance Agreement with Creditos ProNegocio



On June 22, US Ambassador to Mexico, Antonio O. Garza Jr., and USAID/Mexico Mission Director Edward Kadunc met with Luis Peña Kegel, CEO of Banorte, and ProNegocio Director Jose Carlos Martinez to inaugurate assistance from AFIRMA.

3.2 TASK 2 – DEVELOP A LOCAL, COMMERCIALY-BASED MFI SUPPORT SERVICES INDUSTRY

A local support services industry is key to the growth of microfinance in Mexico, and AFIRMA is working to improve the supply of services and human resources that MFIs demand (see box below). In order to better understand this market, during year 2 AFIRMA has examined the *supply* of and *demand* for support services. AFIRMA evaluated consulting and training firms, building upon the initial survey conducted in August 2005 and focusing primarily on the current supply of service.

Early in Year 2, Acción senior consultant Ricardo Calvo, worked with Katie Kohlstedt, a Mexico-based microfinance consultant with knowledge of the local services providers in Mexico, to interview various training firms, technical assistance providers, independent consultants and specialized microfinance consulting firms, to gain a more complete understanding of the market for microfinance support services.

In addition to identifying services provided and evaluating firms, this activity highlighted that developing this industry will require a variety of approaches, and based on this study and other project experience, lines of action outlined in the Year 2 work plan were adjusted in coordination with USAID to better focus efforts and resources. The components of the adjusted approach included four lines of action: (1) increased use of local consultants and firms (2) accompanying the work of local consultants and firms (3) a mentoring program for junior professionals with interest in microfinance, and (4) coordination with the microfinance association, ProDesarrollo. Each of these initiatives is described below.³

MFI Demand for Support Services

The areas of greatest **strategic importance**, according to AFIRMA partners, in order of importance:

- Planning and strategy
- Product design and adaptation
- Management Training
- Credit Analysis
- Legal Structure
- Operational Training

The primary services currently needed for **daily operations** were, in order of importance:

- Operational and Management Training
- IT Systems
- Product Design and Adaptation
- Credit Analysis
- Human Resource Management

3.2.1 Contracting Local Consultants and Firms

Whenever possible, support to strengthen MFIs provided under Task 1, or in connection with an industry event (Task 5), was combined with supporting local services by matching qualified local firms and consultants with international specialists. Aligned with this approach, AFIRMA policies for local firms under Task 1 initiatives were adjusted during the AFIRMA two-day retreat in July to avoid disincentives to contracting local firms and to avoid distortion of the local market for support services.

Results for activities with local firms and individual consultants under Task 1:

- AFIRMA continued to foster ties between MFIs and local firms and consultants that showed good potential and good results on previous assignments, while continuing to improve the microfinance-related knowledge and experience of local providers through close consultation with the project.
- AFIRMA completed files of each local firm and independent consultant contracted under AFIRMA tasks, based on Ms. Kohlstedt's work and the brief profile format designed, which includes profile, performance record, and specific results.
- AFIRMA created an evaluation tool for local consultants and firms working under Task 1, to be submitted to Institutions next quarter in order to evaluate performance. The results will be included in the file of each local provider (firms & independent consultants).
- The project worked with local firms and consultants, extended to initiatives under the other 4 tasks of the project (Tasks 1, 2, 3, & 5) especially related to training programs such as those organized by ProDesarrollo. AFIRMA contracted 12 independent consultants and 8 local firms for training or technical assistance during the year.

³ A more complete description is provided in the AFIRMA Year 2 Work Plan.

Work with each local firm or independent consultant is briefly described in the following table ordered by AFIRMA partner or Task supported:

Table I – AFIRMA use and development of local firms and consultants

MFI/Task	Project	Local Firm or Consultant
AMUCSS	Accounting, RRHH & Operations.	Martin Yedra finished his contract with AFIRMA for improve its accounting system, being contracted directly by AMUCSS for this function. Alejandro Fernandez started to work, supervised AFIRMA Senior Microfinance Willy Escobedo, as operations resident. Alejandro Benitez was hired to support AMUCSS to design and set up a labor strategy that allows personnel to be incorporated in the "IMSS", as well as to define a benefits program.
AMUCSS	Second phase MIS implementation	CTI , a small firm based on Mexico City, which provides technical assistance in management information systems continued work with AMUCSS.
AI Sol	Tax & Legal Advisory	Estrategia Fiscal (ESFI) , a small accounting, audit & tax advisory firm established by Rene García , a consultant with experience on the <i>Ley de Ahorro y Credito Popular (LACP)</i> , completed in September, tax & legal analysis on implications of the transformation process <i>from A.C. to S.A. de C.V.</i>
CADEMI	Tax & Legal Advise	Desarrollo Empresarial Anjona (DEA) is a small firm based on Mexico City, which provides accounting, audit & tax support and advisory services to AFIRMA, and now to microfinance institutions, with CADEMI.
Pro Mujer	Team member in MIS evaluation.	Juan Flores , worked under MIS expert Gabor Simon supervision at PMM, in MIS evaluation process. During next quarter in order to tap of the training provided, he will work with Ricela Muñoz at CAME.
ProMujer	Market Study	SERTA , the local marketing firm, completed work in late 2005 on a market study for PMM. The final product that PMM required more input and analysis from DAI consultants than originally hoped, but the results and database from the studies were useful for developing a market strategy.
FINCA	HR & Training	Due to good results on previous projects, and as result of an open competition process, GIEM , a local training firm, was hired to deliver 3 modules within FINCA University first training program, directed to middle-level managers. In addition, Vayda Sosa , finished her work to improve human resources management of FINCA, which included a module within the same program.
FINCA	Legal Advisory	AFIRMA contracted Link Internacional , a high specialized legal firm, to analyze FINCA's legal options to become a regulated MFI.
Task 2	Training junior consultants @ IPN	AFIRMA hired local microfinance research specialist Pilar Campos to deliver a module within the IPN microfinance training program for young professionals.
Task 2	Training junior consultants @ IPN	Luis Heriberto Garcia Muñiz , supported, with excellent results, the microfinance training program for young professionals
ProDesarrollo	Training & Benchmarking	Fernando Pamos , an accounting and financial analyst specialist with over 15 years of experience working with banks, delivered a training program on accounting for MFIs in Mexico City and Chiapas. Deloitte presented compensation study results during an event organized by ProDesarrollo and AFIRMA in August. Samuel Perez was hired as a resident consultant to strengthen ProDesarrollo's Benchmarking system. He will be trained on the ob, working closely with AFIRMA.

Next quarter, AFIRMA will contract FINDES, a local firm to deliver 3 training modules as part of the first training program of FINCA University, geared towards middle-level managers. According to AFIRMA's approach of decreasing subsidy, the last three local firms' payments (*GIEM, Link Internacional & FINDES*) will be shared by FINCA and AFIRMA. Also, AFIRMA in coordination with FinComún will carry out an open competition to select a firm to assess the institution's training systematization process and needs. Next quarter, AFIRMA Microfinance Training Specialist Claudette Martinez will:

- Distribute the evaluation tool for local consultants and firms working under task I to partner MFIs, in order to evaluate performance.

- Examine the possibility of publishing local providers' profiles on the AFIRMA web page. AFIRMA will meet with Microfinanzas.net director to evaluate the possibility to incorporate this information in its consultant database as well.

3.2.2 Microfinance-Specific Skill-Building and Linkages

Through the project's interaction with local firms and consultants, it is evident that Mexico has substantial general human resources and consulting capacity, but continues to have limited specialized consulting capacity for microfinance, and significant differences in quality of services from one region to another. One goal under Task 2 is to strengthening consulting and training firms, universities and research firms in priority areas for AFIRMA's partner MFIs.

AFIRMA continued working to improve local firm's knowledge of microfinance-specific topics through close consultation with the project and partnering with international specialists (where practicable) and strengthening MFI capacity to contract their services through information sharing and coordination of efforts. The project also continued to promote use of high-quality support services such as external audit, rating and legal advisory; and will continue inviting local firms to AFIRMA events.

3.2.3 Mentoring Program

There is no shortage in Mexico of intelligent, educated, young professionals who, with the right training, could fill positions in AFIRMA partner institutions or work as microfinance consultants. However, part of the general training that is missing in Mexico is an intensive, practical course to offer young professionals some of the understanding and tools required to work effectively in microfinance. AFIRMA's approach to addressing this challenge includes classroom work and practical application through field work (possibly pairing with the required Social Service work and internships) for qualifying students.

As an important first step in developing junior professionals for the microfinance sector, AFIRMA established initial understanding and a memorandum of understanding with the National Polytechnic Institute (*Instituto Politécnico Nacional - IPN*), one of the largest public universities in Mexico, to deliver a pilot training for young professionals and professors of the *IPN*. Last quarter, AFIRMA designed and delivered one-week microfinance induction course, which was attended by 24 participants, including 19 top-ranking students and 5 professors, all from the Economics School.

The course was held August 28 to September 1 at the IPN campus in Mexico City and was delivered by the AFIRMA internal technical team along with the following specialists: Dr. Claudio Gonzalez Vega, Robin Young, Pilar Campos, Heriberto García, and Michael Steidl. In addition, to include a practical vision distinguished guest speakers were invited to participate, including regulators and MFIs directors.

Interest to support this initiative was excellent, as demonstrated by the participation of 10 leading figures in Popular Finance in Mexico: ⁴

Name	Organization
Dr. Rafael del Villar	Banco de Mexico (Central Bank)
Rodrigo Sanchez Arriola	CNBV (Bank Regulator)
Luis Rosendo Gutierrez	Financiera Rural
Ramon Imperial	Caja Popular Mexicana
Alfredo Hubbard	CAME
Maria O'Keefe	Pro Mujer
Gonzalo Puente	FINCA Mexico
Luis Gallegos	FinComún
Ramiro Montelongo	Credito Pronegocios
Javier Vargas	Pro Mujer

On September 5, AFIRMA held an evaluation session with USAID Development Finance Advisor Geoffrey Chalmers and Directors of the IPN Economics School (ESE) to review results and next-steps, which included:

- **First group follow up** - Enrich the classroom work through two-day field visits to MFIs.
- **Microfinance Research** - Identify microfinance-related topics to incorporate into IPN research programs
- **Interaction Among Students and MFIs** – Design a professional development program for students, possibly pairing with required Social service work.
- **Dissemination** – Activities carried out as part of the training should be disseminated to promote interest in microfinance topics at the IPN.
- **Microfinance learning program** – Design and implement a program to transfer specialized knowledge to the IPN curriculum.

AFIRMA began follow-up meetings and visit to MFIs organization to finalize the first phase of this activity, with assistance from Heriberto Garcia, a Mexican microfinance specialist who coordinated the pilot initiative along with IPN directors and Claudette Martinez.

AFIRMA's leader for this activity, Claudette Martinez, will work with Heriberto Garcia and the IPN to examine how the microfinance education program can be implemented as part of the IPN curriculum. Next quarter, priority activities under this component include:

Microfinance Course at the National Polytechnic Institute



In August-September, AFIRMA organized and delivered a highly successful pilot course, "Introduction to Microfinance" with students and professors from the National Polytechnic Institute (IPN), which met with great acceptance among sector leaders, as evidenced by their willingness to volunteer their time.



The course included presentations by leaders in the popular finance sector such as (from left to right facing the class), Ramon Imperial, Director of Caja Popular Mexicana, Alfredo Hubbard, Director of CAME, and Maria O'Keefe, President of ProMujer Mexico.

⁴ Although, Veronica Osorio from FIMEDER couldn't attend for health reasons, she sent her presentation to be included in the course materials.

- **Practical Experience** – The IPN pilot group will visit 5 AFIRMA Partner MFIs to gain an understanding of field operations. Participants will later present their experiences in an open seminar for ESE students, where, students and professor will share experience from the pilot course. Based upon participant performance in the complete program, AFIRMA will select junior professionals to participate in practical assignments coupled with senior consultants on technical consultancies. To support these mentoring projects, AFIRMA will help defray the intern's transportation and meals expenses.
- **Establish an agreement & finalize work plan with IPN** – AFIRMA will work with USAID to design a work plan for this program basis for the cooperation agreement with IPN, expected to include the 4 pillars identified during the evaluation session:
 - Design and implement a microfinance learning program as part of the IPN Curriculum
 - Coordination with research activities
 - Professional development program to assure interaction between students and MFIs
 - Evaluation and monitoring results tools and diffusion activities

The Second microfinance training program with IPN, to be adjusted based on feedback, is expected to be designed in early 2007.

In addition to the activities with the IPN discussed above, AFIRMA continued to work with, and improve, the services of local independent consultants under Task I. Based on positive advances and knowledge gained during last quarter, AFIRMA will extend the contract of Juan Omar Flores to continue working under supervision of senior consultants (Carlos Paredes, Gabor Simon and Willy Escobedo) on new information system projects for FINCA, CAME and others. Following this extension AFIRMA will formally evaluate his performance through feedback from senior consultants and MFI partners.

3.2.4 ProDesarrollo

AFIRMA has worked with ProDesarrollo to define priority areas for support based on its strategic plan. Following consultation with Prodesarrollo and USAID, AFIRMA focused support on:

- **Benchmarking** – AFIRMA wrote a position description, and supported the selection and recruitment of Samuel Perez, a junior consultant hired to strengthen the ProDesarrollo benchmarking system. He will work closely with the Director of PD and with Nate Bourns at AFIRMA to develop information products for the microfinance market, as well as a commercialization plan for this type of information.
- **Planning of Training Initiatives** – AFIRMA Training specialist Claudette Martinez worked closely with ProDesarrollo last quarter to address the approach to planning, designing and delivering training events, one of the areas that Prodesarrollo has identified as a priority in improving the organization's sustainability.
- **Accounting and Internal Control for Microfinance** – In August, AFIRMA supported two training programs on accounting and internal control for MFIs, one of which was the first PD training program held in Chiapas. Alejandro Guevara, the manager of internal audit at *Caja Municipal de Arequipa* (Peru), and Fernando Palmos, a Mexican accounting and financial specialist with knowledge of CNBV regulation in this topic facilitated the courses. The program met with high demand (an average of 25 participants) and was well received by participants.

- **Microfinance Network Study Tour** – In September, AFIRMA supported a study tour to familiarize new PD staff with microfinance association experiences in Peru (*Copeme*) and Ecuador (*Red Financiera Rural*) and their relevant initiatives in training and benchmarking.

Additionally, Claudette Martinez, Microfinance Training specialist is supporting the organization of Fourth Microfinance Leadership Conference, planned for early 2007 and will support logistics expenses. Next quarter AFIRMA will formalize an institutional agreement with ProDesarrollo.

3.3 TASK 3 – SUPPORT INNOVATIONS TO EXPAND ACCESS TO RURAL FINANCE & REMITTANCES

Implementation of Task 3 involves a grants-based approach to stimulating the introduction of new technologies, approaches, distribution channels, or other elements that facilitate rural clients' and small farmers' access to appropriate financial services, and to improve institutions' capacities to reach underserved populations, especially rural clients. During the year, AFIRMA worked closely with USAID Development Finance Advisor Geoffrey Chalmers on an approach to this task based on emerging lessons learned and good practice in rural and agricultural finance.

3.3.1 Rural and Agricultural Finance Workshop

During the second and third quarters of this year, AFIRMA worked closely with Mr. Chalmers in coordination with USAID/Washington and the Washington-based firm QED to adjust and deliver the RAF workshop material for Mexico and for an audience formed primarily of practitioners.⁵ The workshop held June 21-23, was facilitated by Robin Young, Rodolfo Quiros, and Pilar Campos. Twenty-one participants (not counting AFIRMA and USAID) from around Mexico attended the workshop, many of whom were Executive Directors or managers of financial organizations. Of these, Three representatives from the donor community (UN ECLAC, Ford Foundation and IDB) participated actively, and there were three participants from other USAID projects, two from WOCCU and one from IPRC (Chemonics) each of whom made valuable contributions.

Interactive RAF Workshop Adapted for Mexican Practitioners



A group of managers of financial institutions, donors and other practitioners gathered in San Miguel Ometuzco on June 21-23 for an adapted version of USAID's Rural and Agricultural Finance Workshop.

Key outcomes and next-steps (in addition to the Fund described in the following section) emerging from the workshop included:

⁵ The initial RAF was designed as an internal training for USAID staff

- **Interaction between commercial banks and MFIs** – Participants cited the need for better communication between these two groups of actors, in order for banks to understand how MFIs operate and for MFIs to know what banks need in order to be able to lend to them. The MFI's indicated their hope that this could lead to alliances among organizations on the basis of business relationships and creditworthiness, rather than purely on the basis of government-backed guarantees.
- **Macro environment** – Participants noted that positive political context, independent of the incoming Mexican Administration, as an opportunity for the sector, but few felt prepared to take advantage of the opportunity, and felt that the sector is lacking a common vision that it could articulate. AFIRMA will work with USAID to determine its role in supporting members of the sector in informing the incoming government of priorities.
- **Stakeholders' Workshops** - This would involve short, locally held workshops for specific agricultural value chains involving a variety of actors, including financial service providers, depending on interest/demand.
- **Practical Research** – In connection with the TIES Project with AFIRMA partner OSU, the project will examine rural and agricultural finance-related topics that require further understanding.

3.3.2 Design and Launch Innovation Fund

AFIRMA took lessons from the RAF, ongoing project activities, and a visit to rural producers in Oaxaca that are part of the USAID-funded IPRC program, to design the Innovation Fund in coordination with Geoff Chalmers. AFIRMA DCOP Nathanael Bourns, worked with Grants Administrator Francisco Carbajal and DAI consultant Brooke Jones, to determine the broad lines of support the fund would provide. The team drafted an Annual Program Statement, a Technical Overview, and a Grants Administration Manual for the fund. These documents were submitted to the USAID/El Salvador Contracts Office for approval.

i-FAR Objective

i-FAR will seek to expand access to rural and agricultural finance by encouraging innovative business models and technologies for providing financial services.

In order to meet its objective (see box), the *Fondo i-FAR (Innovacion en Finanzas Agricolas y Rurales)* will support pilot programs for strategic alliances among financial institutions and value chain actors, and used in efforts to overcome current market failures, inefficiencies, information asymmetries, and value chain bottlenecks, with the end goal of expanding services to the rural sector in Mexico.

AFIRMA will use the fund primarily to support financial institutions that provide rural and/or agricultural financial services, or are expanding into those markets. Non-financial, non-governmental actors will also be considered, provided the proposal promotes innovations or alliances seeking to create, expand, or strengthen the supply of financial services products for rural or agricultural actors.

Due to the nature of innovation, the fund is designed to be a flexible tool with which the AFIRMA project can encourage investments in expanding access to rural and agricultural finance. Private actors themselves will be best capable of identifying needs, improvements, innovations, and strategic alliances. Given these characteristics, along with rapid changes in the financial sector in Mexico, flexibility to

support innovative initiatives as they arise is paramount. Therefore, following advice from USAID/Mexico, AFIRMA will use an Annual Program Statement under which initiatives may be funded, given that mechanism's greater level of flexibility, as compared to a request for applications.

Nate Bourns is responsible for Fund Management, with day-to-day assistance from Francisco Carbajal. On October 25, they presented an overview of the fund to Regional Contracts Officer Tracy Miller and Acquisition Specialist Beatriz de Chinchilla of USAID/El Salvador, on temporary assignment to USAID/Mexico. Ms. Miller and Ms. Chinchilla provided very useful feedback and recommended adjustments to the draft manuals, which is currently being incorporated into the final documents.

During the next quarter AFIRMA will:

- **Adjust the APS, Manuals and obtain final approval for the fund**
- **Launch the Innovation Fund** – AFIRMA will make available a simple format to follow for interested parties to present short descriptions of proposed innovations. The target for launching the fund is January 2007.
- **Review technical proposals** – a review committee (representatives from USAID, AFIRMA, and an external reviewer) will use established criteria to review proposals and select initiatives to support.

3.3.3 Identify Areas for Intervention in the RAF Enabling Environment

Depending on lessons learned through the grant fund and other activities, AFIRMA and USAID will assess whether any legal/policy issues related to rural and agricultural finance emerge as high-priority obstacles worthy of consideration for USAID/AFIRMA intervention, most likely in close coordination with private sector actors and the Mexican Government.

3.4 TASK 4 – STRENGTHEN THE REGULATORY ENVIRONMENT FOR MICRO- AND RURAL FINANCE

Activity under this component was less intense than originally envisioned in the Year 2 Work Plan due to the period of government transition and to changes in personnel among those responsible for implementation of the Popular Savings and Credit Law (LACP) within the *Comision Nacional Bancaria y de Valores* (CNBV). COP Fernando Fernandez maintained regular contact with representatives from the CNBV responsible for LACP implementation, and began to work directly with the new CNBV General Director of Supervision of Popular Savings and Credit Institutions, Rodrigo Sánchez Arriola Luna, offering assistance with implementing supervision and regulation of microfinance

In September, Mr. Fernandez and Geoffrey Chalmers accompanied three key CNBV representatives on a study tour to Peru and Ecuador in mid-September to learn and experience the details of the regulatory and supervisory system for Popular Finance Institutions (Credit Unions, Cooperatives, and Microfinance Organizations) in both countries. The Study tour included visits with the Bank Superintendencies of each country, credit bureaus, and several regulated microfinance institutions. Upon returning to Mexico, in a follow-up meeting with the COP and CTO, CNBV participants expressed gratitude for the opportunity to improve their understanding of the micro- and rural finance sector.

Upcoming projects with the CNBV are initially scheduled to involve:

- **Work plan with the CNBV** – The Project will coordinate with the CNBV to develop technical assistance and training plans with the Federations.

Based on planning with the CNBV next quarter, the project will define further activities.

3.5 TASK 5 – STRENGTHEN THE MICRO- AND RURAL FINANCE INDUSTRY

AFIRMA efforts for Task 5 include supporting initiatives with GoM agencies, private sector stakeholders in microfinance, and other industry initiatives such as improved access to various types of market information. Initiatives over the year are divided into three basic categories: initiatives with GoM agencies, initiatives with private sector stakeholders in micro- and rural finance, and other industry initiatives.

3.5.1 Initiatives with GoM Agencies

PRONAFIM

AFIRMA continued a highly successful partnership with PRONAFIM, the National Program for Microenterprise Finance (*Programa Nacional de Financiamiento al Microempresario*) within the Secretary of the Economy through the course of the year. After AFIRMA's support of the design of the Fourth National Encounter for Microfinance, PRONAFIM invited AFIRMA to assist with planning the subsequent event, held May 29-31 2006 in Guadalajara. AFIRMA arranged plenary presentations for USAID Mission Director Edward Kadunc (see box), and three breakout sessions highlighting the performance of 5 of the AFIRMA partner MFIs, facilitated separately by AFIRMA staff Fernando Fernandez, Nate Bourns, and Willy Escobedo.

Mission Director Kadunc Presents at the 5th National Encounter on Microfinance



On May 30 USAID/Mexico Mission Director Edward Kadunc presented USAID's support of microfinance to a national group of microfinance practitioners, service providers, and representatives of the Secretary of the Economy.

Due to the positive working relationship developed with PRONAFIM, the program has given AFIRMA access to their extensive institutional database, with which AFIRMA is completing a mapping exercise (see section 3.5.3 below) to identify which markets are currently being served by microfinance organizations.

Through regular consulting meetings with PRONAFIM, AFIRMA has helped PRONAFIM analyze the need to adjust the program's focus towards an increasingly market-oriented approach, where the public sector acts more as stimulator and promoter than a direct market actor. The PRONAFIM director has recently requested that AFIRMA and the Secretary of Economy sign a Memorandum of Understanding for the project to further strengthen PRONAFIM, and AFIRMA is preparing an MOU for USAID to review and possibly sign next quarter.

Banco de Mexico

Beginning in late 2005, AFIRMA Credit Bureau Expert Miguel Llenas worked with COP Fernando Fernandez and DCOP Nathanael Bourns to coordinate with the Banco de Mexico in carrying out a diagnostic of the credit information environment, a critical element for sound development and further deepening of the Mexican financial system. AFIRMA has continued to coordinate closely with and is currently assisting with an internal study to examine options to improve the regulation and supervision of credit information services, with the objective of increasing transparency of credit information in the Mexican market and reduce overall risks. The project will continue to coordinate efforts with representatives of the *Banco de Mexico*, in an effort to expand access to credit information, as one way to deepen the shallow Mexican financial market.

Additionally, AFIRMA was invited directly by the Banco de Mexico to participate in a meeting on “Free Competition in Mexico” organized by Leaders & Boards and the *Club de Industriales*, held in mid-October 2006.

3.5.2 Initiatives with private sector stakeholders in micro- and rural finance

Credit Information Services – *Circulo de Credito*

AFIRMA offered assistance with designing products and processes to serve the popular finance sector in Mexico to both of the private credit bureaus. *Circulo de Credito* has responded enthusiastically, and Miguel Llenas worked with *Circulo de Credito* to develop information products and processes tailored to the popular finance sector. *Circulo* has since launched its product for microfinance, which has been well-received among MFIs.

3.5.3 Other Industry Initiatives

Market Study

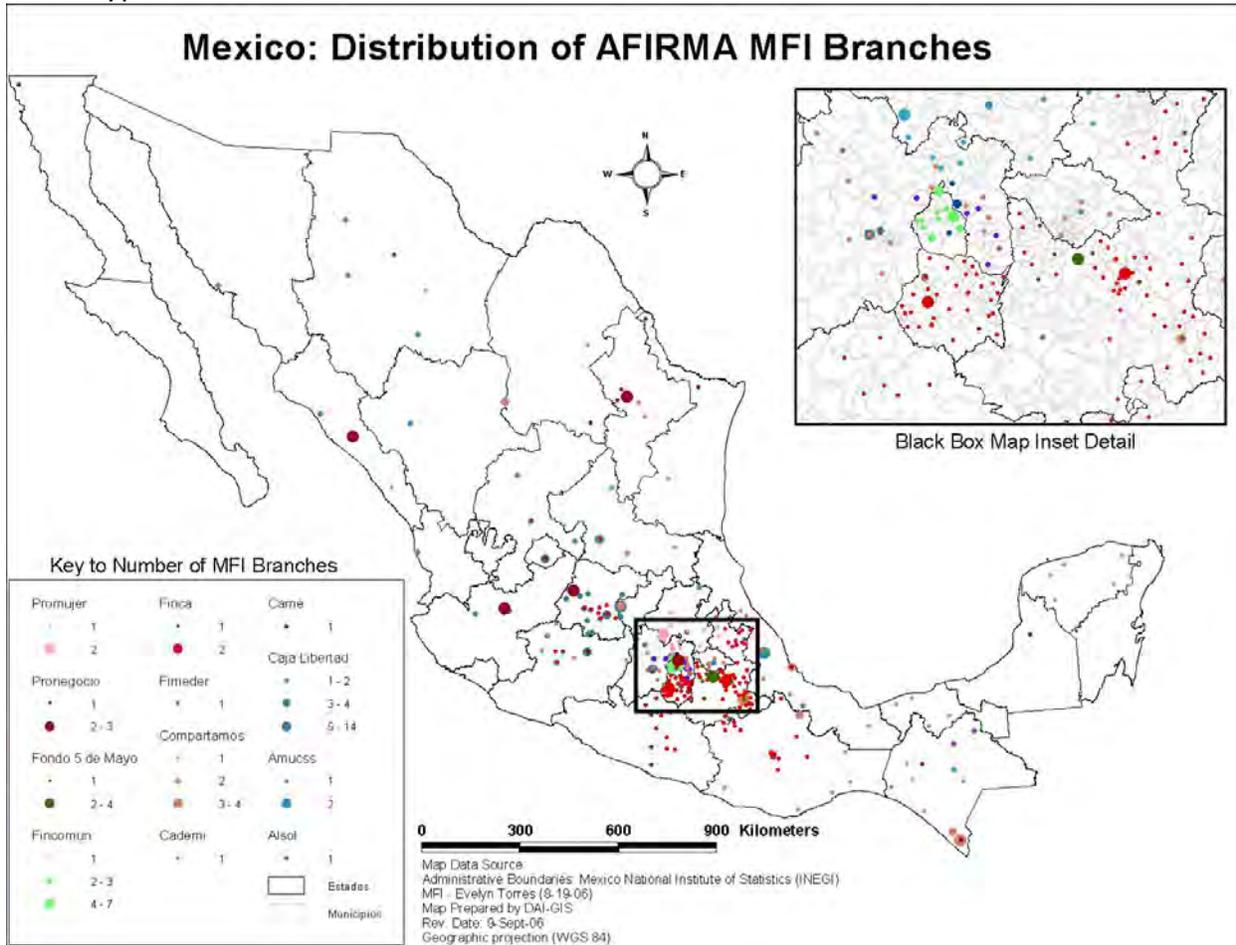
AFIRMA subcontractor The Ohio State University, led by Dr. Claudio Gonzalez-Vega presented findings of several studies conducted on rural financial markets in Mexico conference co-sponsored by USAID on “Building Inclusive Financial Systems in Mexico” at the CIDE University in mid-October. Feedback from this conference will be incorporated into the final documents.

Given the rapidly changing Mexican market, AFIRMA and USAID have decided that additional research topics will require shorter-term, faster studies, to ensure that they are available to AFIRMA partners on a timely basis.

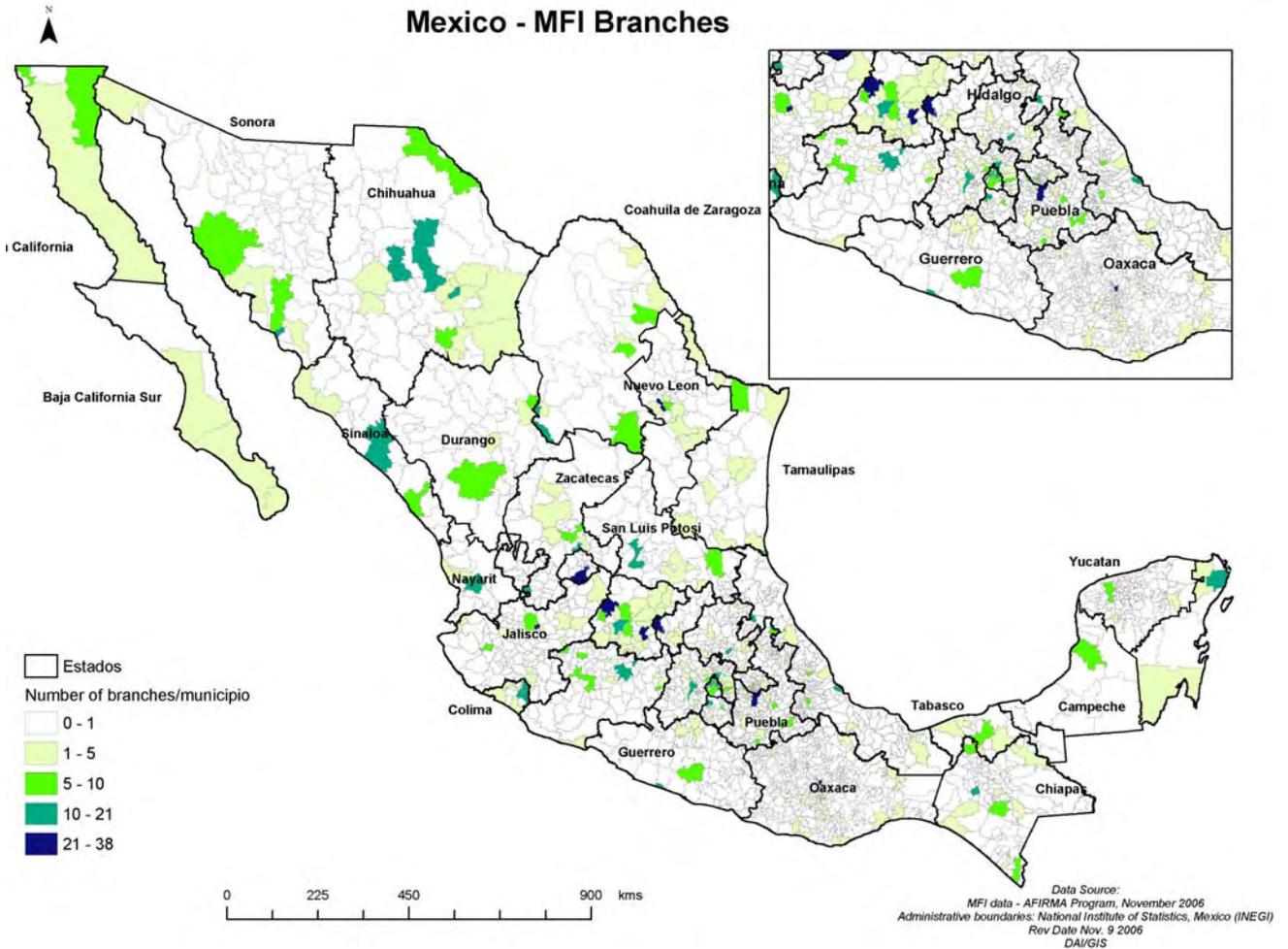
Mapping

AFIRMA began an initiative led by Nate Bourns and supported during the summer by intern, Evelyn Torres of the University of California San Diego with generous support of Bob Bouvier and Ioana Bouvier, of DAI’s home office Geographic Information Systems (GIS) team to map the branch locations of AFIRMA partners. Given demand within the sector, this effort has since expanded and AFIRMA has begun tracking other institutions as well. A *preliminary* map of the branch locations of AFIRMA partners

appears below, followed by an initial effort to map branch locations of 77 popular financial institutions of various types.⁶



⁶ ACCEDE, Activo Empresarial, ADMIC, AISol, AMUCSS (redes MB), ATEMEXPA, ADEM, ASP Consultores, Batoamigo, Caja Depac Poblana, Caja Inmaculada, Caja Libertad, Caja Popular Cristobal Colon, Caja Popular La Providencia, Caja Popular Mexicana, CAME, CADEMI, Central de Servicios para el Desarrollo Rural del Estado de México, Compartamos, Consultores Asociados del Centro Sureste, CREDIMEX, Consultoria para Negocios Agroindustriales CREDIEXPRESS, Crédito Familiar, Despeno, DEMIC Despacho Alfonso Amador y Asociados Despacho de Profesionistas Agropecuarios, Emprende y Progres, EMPRO Consultores, Espacios Alternativos, EurekaSoli, FIMEDER, FINACER, Financiera Independencia, Financiera Tamazula, FINAPRO, Finca México, FinComún, FinSol, FONDO 5 DE MAYO, Fondo Solidario del frente Democrático Campesino, FECHAC, Microrred, Promotora de Servicios Rurales, PROMUJER, ProNegocio, Provident Financial, Proyectos Empresariales de Durango, Regional de Tlapacoyan, SADEC, Salud y Desarrollo Comunitario de Cd. Juárez, SERFINSO, SERFIR, Servicios Agropecuarios Fraylescanos, Servicios Integrales a Mujeres Emprendedoras, Sociedad Cooperativa de Ahorro y Préstamo Solidum, Sociedad Financiera de Crédito Popular Nacional, SOLFI, Soluciones Financieras Internacionales, STA FE CUERNAVACA, STA FE GUANAJUATO, STA FE JALISCO, STA FE QUERETARO, STA FE SAN LUIS POTOSI, STA FE ZAMORA, TLAPACOYAN, CIENEGA Unión de Crédito de Gómez Palacio, UCEPCO, Unión de Crédito General de Puebla, UDGP, Unión de Crédito Industrial y Comercial de Oaxaca, UNICREICH, UNICREMIV, UCMZ, Unión Progreso.



Given the sector's rate of expansion, these maps are snapshots taken at a given point in time, and the initiative's true value will depend upon the ability to maintain the data up-to-date. In order to build on this effort, AFIRMA will look for a home for the initiative (at an academic institution, the statistics bureau (INEGI), a network or other Mexican institution) a local "champion" of the effort to work with a Mr. Bouvier from DAI/GIS specialist that could support the initiative on a short-term basis. The project also will begin to incorporate other relevant data on poverty, population, rural municipalities, that is available through INEGI.

4. PROJECT MANAGEMENT

Major developments in project management during the year included:

- **Administrative re-organization** – Based on experience from AFIRMA’s first year, and due the workload and intensity of activities, AFIRMA management decided to examine its internal operations in order to adjust approaches to administration to help ensure compliance with USAID regulations while also clarifying roles and responsibilities. This involved adjusting staff responsibilities (within the original contract SOW) to meet the needs for 2006 and beyond, while playing to the strengths of each member of the team. Related to these changes, former USAID EM-DAP Fellow Ivana Fertziger joined the AFIRMA team, initially for a 6-month assignment, to assist in coordinating with partner MFIs. Adjustments deemed necessary for 2007 will be discussed with USAID next quarter.
- **Technical backstopping support from DAI Microfinance Specialist Robin Young** – Robin Young took over technical backstopping support for AFIRMA, providing excellent support of AFIRMA’s planning processes and guidance on technical and project management issues..
- **Support from DAI Home Office Associate Brooke Jones.** In addition to her technical work with ProMujer, Ms. Jones assisted local staff with process mapping of the main administrative functions, working with Claudette Martinez to develop a project manual and training staff on use of DAI’s Oracle ERP system that went live January 1, 2006. Last quarter Ms. Jones assisted Nate Bourns with drafting manuals for the i-FAR grants fund.
- **Presentation of AFIRMA at the “Coffee with the Mission Director” meeting** – Upon invitation of USAID/Mexico Mission Director Edward Kadunc, on February 3, Fernando Fernandez and Nate Bourns presented an overview of the project and results to date, upcoming challenges and opportunities for the project within a rapidly changing environment.
- **Programmatic Adjustment to Funding Levels** – Fernando Fernandez and Nate Bourns worked closely with CTO Geoff Chalmers over the year to adjust programming to available funding levels and provided the mission with projections of activities, based on various funding level scenarios. Every effort was made to respond proactively to the need to lower the level of expenditure while remaining responsive to the needs and plans of AFIRMA partners. Priority was given to activities to which AFIRMA had previously committed.
- **Implementation of DAI’s new Information System** –DAI’s Oracle ERP system went live January 1, 2006 and will, once fully implemented, provide greater tools for project management. Initially the changeover has created delays in some processes, including invoicing, but processes were back up-to-date by June.
- **AFIRMA retreat and planning process.** AFIRMA held a 2-day retreat in July to plan for 2007. The first day was spent on reviewing the technical performance of the project and its partners, as well as trends in the Mexican microfinance market with USAID CTO Geoffrey Chalmers. The second day focused on project management and administrative issues, and resulted in the re-organization described above. The retreat was particularly useful from a management standpoint, in order gain clarity on priorities for 2007.

- **Partner Agreements** – In September 2006, the first-phase partnership agreements signed at the beginning of the project expired and USAID and AFIRMA are working with partners to sign new agreements and determine priority areas for assistance.

4.1 AFIRMA BI-ANNUAL PARTNER MEETINGS AND TECHNICAL WORKSHOPS

In January 2006 AFIRMA organized the bi-annual meeting, at which Claudio Gonzalez-Vega and Marcelo Villafani presented findings from the OSU market study, Miguel Llenas presented the credit information services activity, Nathanael Bourns presented the performance monitoring information, and Geoff Chalmers facilitated a feedback session with project partners. A second biannual meeting is scheduled for November 10, 2006.

5. ANNEX A – PROJECT INDICATORS

In January 2006, AFIRMA and USAID CTO Geoffrey Chalmers adjusted the Performance Monitoring Plan (PMP) to the new Strategic Objective and Intermediate Results Framework mentioned in the introduction to this report. AFIRMA updated the PMP and the indicators below.

5.1 TASK I INDICATORS

Table 2 – Task One Indicators

Indicator	Baseline Dec. 2004	Sept. 2006	Variance	LOP Target
I. Strengthen the institutional capacity of MFIs				
I.1. Number of active credit clients	482,959*	836,728	+353,769	Increase of 500,000
I.2. Number of MFIs mobilizing savings deposits	3 (FC, AMUCSS, CL),	4 (+FIMEDER)	+1	6
I.3. Rural clients	TBD	TBD	-	Increase – no specific targets set
I.4. Number of loans to female borrowers (annual)	600,391	Annual (Dec)	-	Increase – no specific targets set
I.5. Value (USD) outstanding loans to women (annual)	\$507,175,818	Annual (Dec)	-	Increase – no specific targets set
I.6. Number of loans under \$400 (annual)	316,775	Annual (Dec)	-	Increase – no specific targets set
I.7. Total Value (USD) of outstanding loans by AFIRMA MFIs (CL, AMUCSS not included PN baseline 6/06)	\$139,816,887	\$295,236,298	+148%	Increase – no specific targets set
I.8. Increased Points of Service	299	344	+50%	Incr. POS 50%
I.9. Increased <i>Rural</i> Points of Service	TBD	TBD	-	Incr. <i>rural</i> POS 50%
I.10. Financial and Operational Self-Sufficiency	5 of 11 FSS.	9 of 12	+4	All MFIs FSS
I.11. Operating Expense Ratio	See Annex B			10 of 12 improve
I.12. Loan officer productivity	See Annex B			All MFIs improve
I.13. Portfolio-at-risk > 30 days	9 under 5%	8 under 5%	-1	< 5% for all MFIs
I.14. Portfolio write-off ratio	See Annex B			Minimize.
I.15. No. MFIs using accepted accounting practices due to AFIRMA support	0 (by definition)	1 (AMUCSS)	+1	No specific targets set.
I.16. Compliance with regulatory standards due to AFIRMA support	0 (by definition)	1 (AMUCSS)	+1	All partners meet requirements
*ProNegocio baseline added as of June 2006, which accounts for higher baseline than presented in previous reporting.				

5.2 TASKS 2-5 INDICATORS

Table 3 – Task 2-5 Indicators

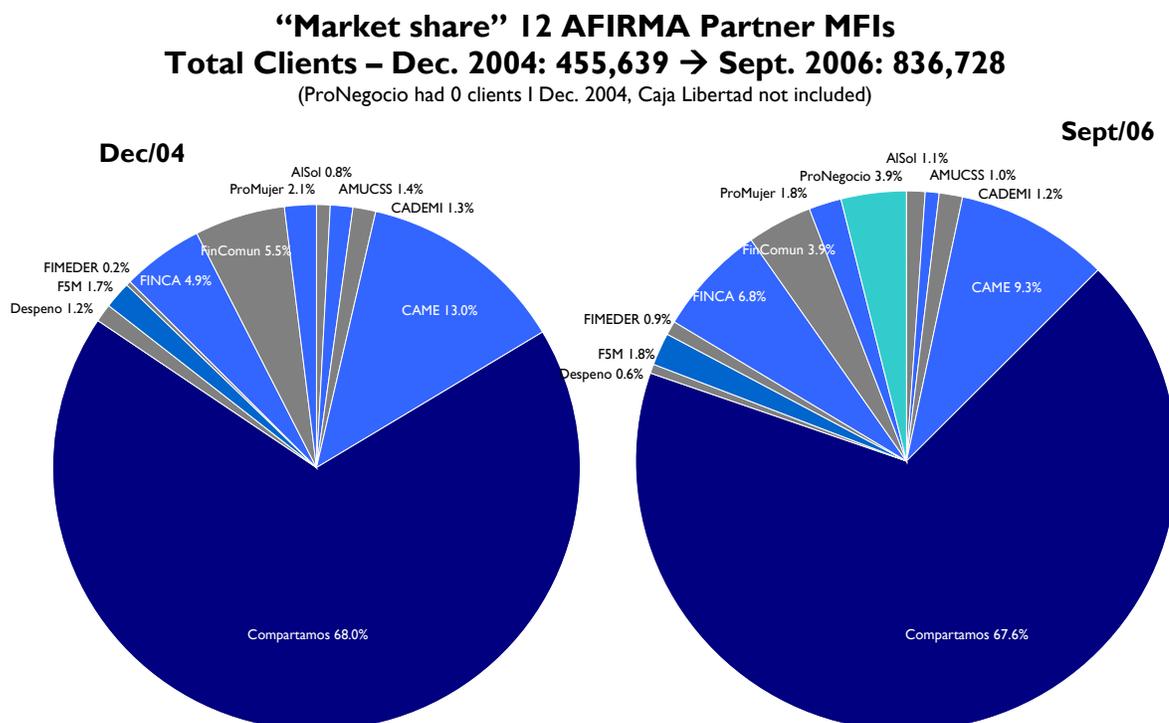
Indicator	Baseline Dec. 2004	June 2006	Variance	LOP Target
2. Develop a local, commercially-based MFI support services industry				
2.1 Number of quality service providers	0 according to Partner MFIs in 2005 survey.	2 (SIN and SIEM)	+2	> 1 quality service provider in each of the 5 most important service areas
2.2 Unsubsidized MFI purchase of local services	Very limited unsubsidized purchase of services	1 (FINCA)	+ 1	> 6 MFIs procuring services at full cost by Year 5
2.3 Number of local firms used	0 (by definition)	9	+9	No specific targets set
2.4 Number of consultants trained in key areas	0 (by definition)	5**	+5	No specific targets set
3. Develop innovative products and technologies that expand access to rural financial services				
3.1 Number of effective innovations supported	0 (by definition)	0	-	5 effective innovations supported
3.2 Increased outreach due to supported innovation	Establish with each innovation as part of application	0	-	Increase – no specific targets set
3.3 Number of new or adjusted products	0 (by definition)	9***	+9	Increase – no specific targets set
4. Develop innovative products and technologies that expand access to rural financial services				
4.1 Work plans for key areas	0 (by definition)	0	-	Annual work plans established and implemented
4.2. TBD based on work plans with CNBV	TBD	-	-	TBD
5. Develop innovative products and technologies that expand access to rural financial services				
5.1 Increase provision of Useful market information	Sparse, disparate information available	Sparse, disparate information available	-	Useful Market information readily available
5.2 Benchmarking system	No effective system	No effective system	-	Global-standard Benchmarking system established

**The work of local consultants Martin Yedra, Vayda Sosa, Maria Olazabal and Rene Garcia with international consultants for the dual purpose of providing TA under task 1 and increasing their capacity. Juan Omar Flores work under Carlos Paredes Supervision, is a practical field-work formation on IT which is one daily operation need detected by MFIs referring support services. Martin Yedra has also participated in AFIRMA-sponsored Audit and Internal Control training. This will expand significantly as the training programs under Task 2 are implemented. This number does not count more than 20 IPN junior professionals, whose practical training is in process following classroom training in August 2006.

***AFIRMA has assisted in the development of New/Adjusted products at FIMEDER, PMM, Despeno, Fondo 5 de Mayo (adjusted 1 solidarity group product, developed individual loan product), FinComún (adjusted 2 products – savings and loan), and Compartamos (re-designed 2: individual and solidarity loan products, with 2 more in process). Other products are in development at Caja Libertad. Products in process are not counted until officially launched.

6. ANNEX B – ANALYSIS OF TASK I FINANCIAL AND OPERATIONAL INDICATORS

As shown in the “market share” charts below, Financiera Compartamos which, following a slow start to 2006, grew dramatically over the last 2 quarters and maintains two-thirds of all microcredit clients among the 12 MFIs for which data is included.⁷ Overall, the 12 MFIs were serving **353,769 more active credit clients in September 2006⁸ as compared to the December 2004 baseline** (counting a June 2006 baseline for ProNegocio, given that work started in mid 2006).



Over the December 2004 baseline, the total growth in credit clients was 73% as of September 2006. On a trailing-twelve-month basis (Sept. 2005-Sept. 2006) growth was 38%. Not surprisingly, three of the four fastest growing institutions, FIMEDER, AISol and CADEMI grew from relatively small bases of clients, while FINCA continues to grow quickly from a larger base. Despeno has gradually recuperated from a decline begun in late 2004 and continues to concentrate, with AFIRMA assistance, on building a sound basis for growth. The baseline for Creditos ProNegocio, set in June 2006, is 27,320 active clients.

⁷ Data for Caja Libertad is not included in the figures cited here for number of clients. CL will do a full portfolio segmentation in connection with implementation of the new MIS. CL estimates that 20% of its active loan clients are microenterprise clients. If this is an accurate estimate, the number as of Sept. 2006 would be 57,278.

⁸ AMUCSS figure is for June 2006. All others are for September 2006.

Total Growth – Life of Project

	Dec-04	Sep-06	Difference	%
FIMEDER	1,090	7,226	6,136	563%
FINCA	22,374	57,258	34,884	156%
AI Sol	3,606	9,055	5,449	151%
F5M	7,587	15,448	7,861	104%
Compartamos	309,637	565,991	256,354	83%
CADEMI	6,048	10,454	4,406	73%
ProMujer	9,386	15,060	5,674	60%
CAME	59,036	77,924	18,888	32%
FinComún	25,038	32,704	7,666	31%
AMUCSS	6,393	8,109	1,716	27%
ProNegocio*	27,320*	32,827	5,507	20%
Despeno	5,444	4,672	-772	-14%
TOTAL	482,959	836,728	353,769	73%

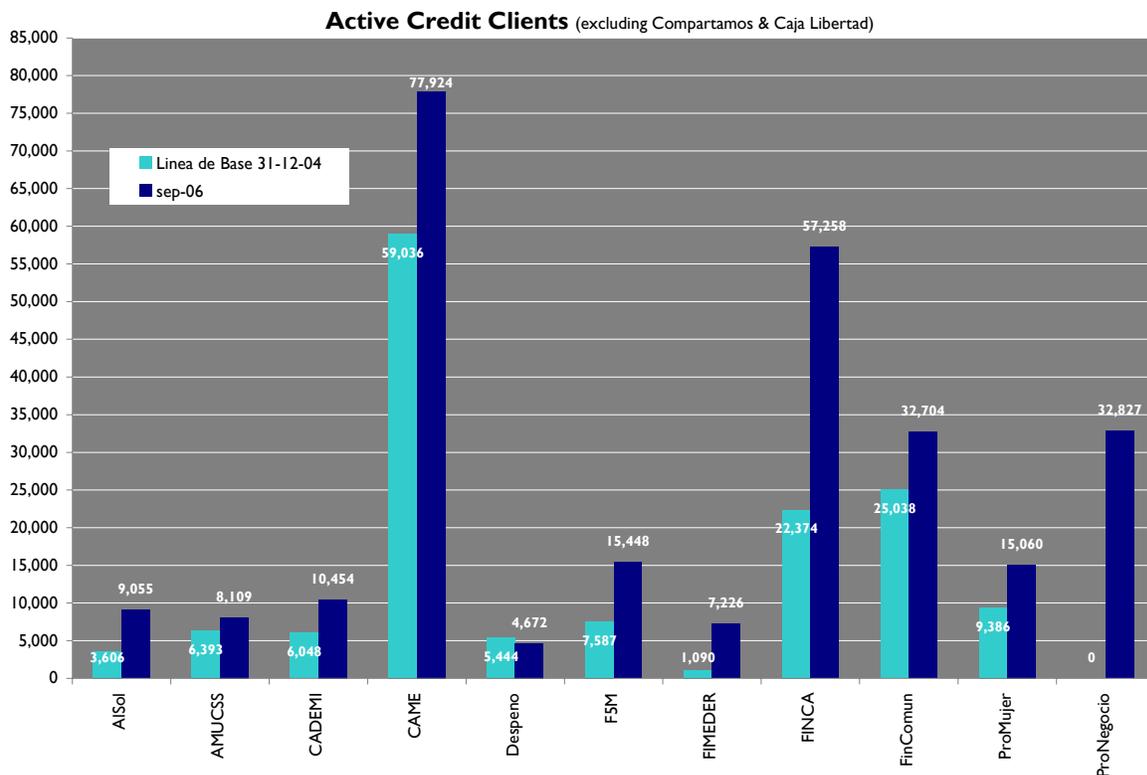
*ProNegocio baseline added as of June 2006, which accounts for higher baseline than presented in previous reporting.

Growth: Trailing Twelve Months

	Sep-05	Sep-06	Difference	%
ProNegocio	10,636	32,827	22,191	209%
FIMEDER	4,039	7,226	3,187	79%
AI Sol	5,085	9,055	3,970	78%
F5M	9,178	15,448	6,270	68%
FINCA	35,102	57,258	22,156	63%
ProMujer	10,618	15,060	4,442	42%
Compartamos	402,007	565,991	163,984	41%
CADEMI	8,333	10,454	2,121	25%
AMUCSS	6,607	8,109	1,502	23%
Despeno	4,303	4,672	369	9%
CAME	76,493	77,924	1,431	2%
FinComún	33,449	32,704	-745	-2%
TOTAL	605,850	836,728	230,878	38%

It is important to note that although **FinComún** has decreased in the last twelve months in terms of active credit clients, it **has grown in savings clients by 83% over the course of the project** (Dec. 2004 baseline) and by 63% in the last 12 months, from 50,229 to 81,776 total savings clients.

The graphic below excludes Compartamos in order to better show the growth in number of credit clients among the other AFIRMA partners which have not grown as much in absolute terms, but have grown as quickly (in some cases more quickly) in percentage terms.



AFIRMA partners have expanded their points of service significantly since December 2004. The total number of points of service of AFIRMA partners increased from a baseline of 302⁹ to a total of 464, an increase of 54%.

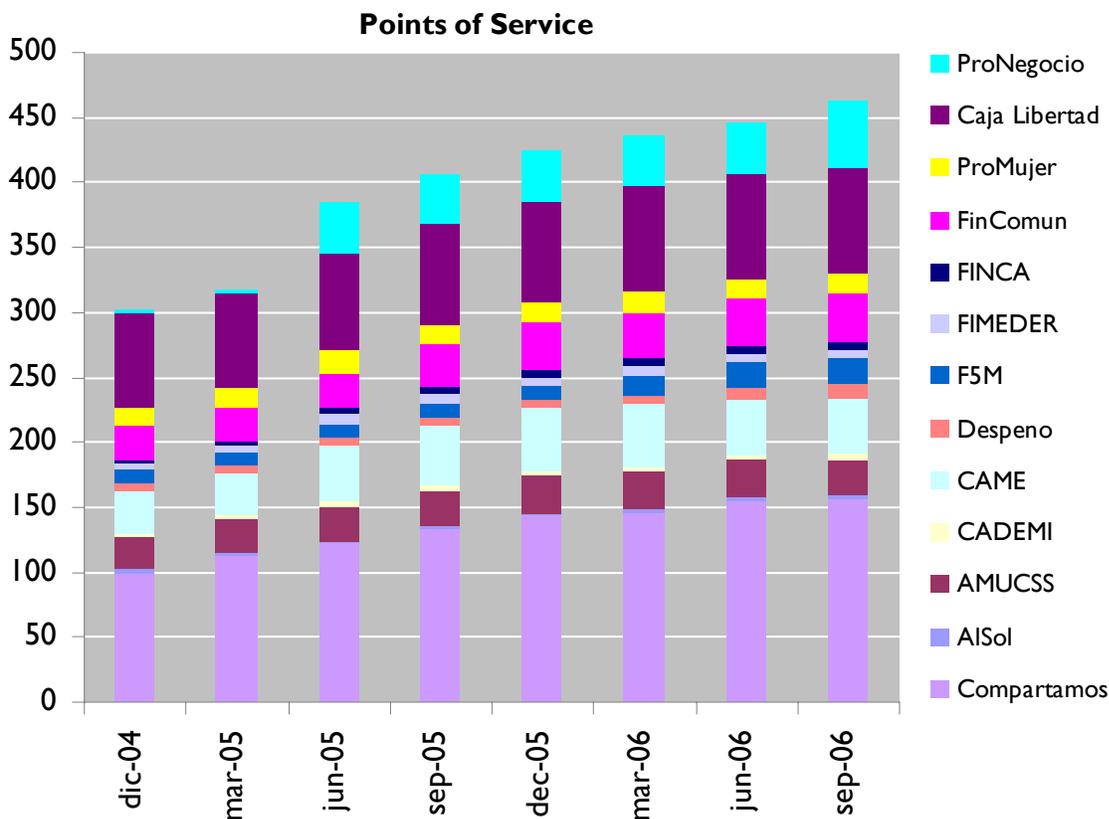
Excluding Caja Libertad, and counting a baseline of 39 points for ProNegocio as of June 2006, the increase was from 227 to 344, a 52% increase.

Most partners have added points of service and Compartamos has grown its structure very quickly from 100 to 156 over 21 months, and plans to close 2006 with 186 points.

Table 4 – AFIRMA Partners Points of Service

MFI	Dec-2004	June 2006
AISol	2	3
AMUCSS	25	28
CADEMI	3	4
Caja Libertad	72	81
CAME	32	43
Compartamos	100	156
Despeno	6	11
F5M	11	19
FIMEDER	5	7
FINCA	3	6
FinComún	25	38
ProMujer	15	16
ProNegocio*	3	52
TOTAL	302	464

*PN Baseline of 6/06 is 39 points of service, so official baseline is 338.



⁹ The official baseline is 338 when ProNegocio's 39 point as of June 2006 are added to the original 299 points of service.

Eight of 12 partners have improved their **financial self-sufficiency**¹⁰ ratios while CAME, Despeno and FINCA decreased. FINCA continues to be profitable and the decline is based on investments in expansion that are likely to yield greater growth in future periods. Despeno's financial results deteriorated significantly as it adjusted its operations and structure to a new market (microfinance vs. subsidized agricultural lending as described above) but improved steadily over the course of the year.

AMUCSS data has recently become available, due in part to AFIRMA's support in developing the MIS and accounting systems. The data shown in the table is preliminary consolidated data as of June 2006. Although the sustainability figure itself is not good, the fact that it can be calculated is an important advance.

Table 5 – Financial Self-Sufficiency

MFI	Dec-2004	Sept. 2006
AlSol	62.4%	110.8%
AMUCSS	N/A	67.8%
CADEMI	119.9%	142.2%
Caja Libertad	78.3%	106.7%
CAME	99.9%	97.0%
Compartamos	166.9%	179.4%
Despeno	106.2%	70.8%
F5M	67.1%	108.3%
FIMEDER	10.9%	101.7%
FINCA	142.7%	117.7%
FinComún	104.3%	118.4%
ProMujer	59.0%	120.5%
ProNegocio	3.5%	90.4%
Average (excl. PN)	92.5%	113.7%

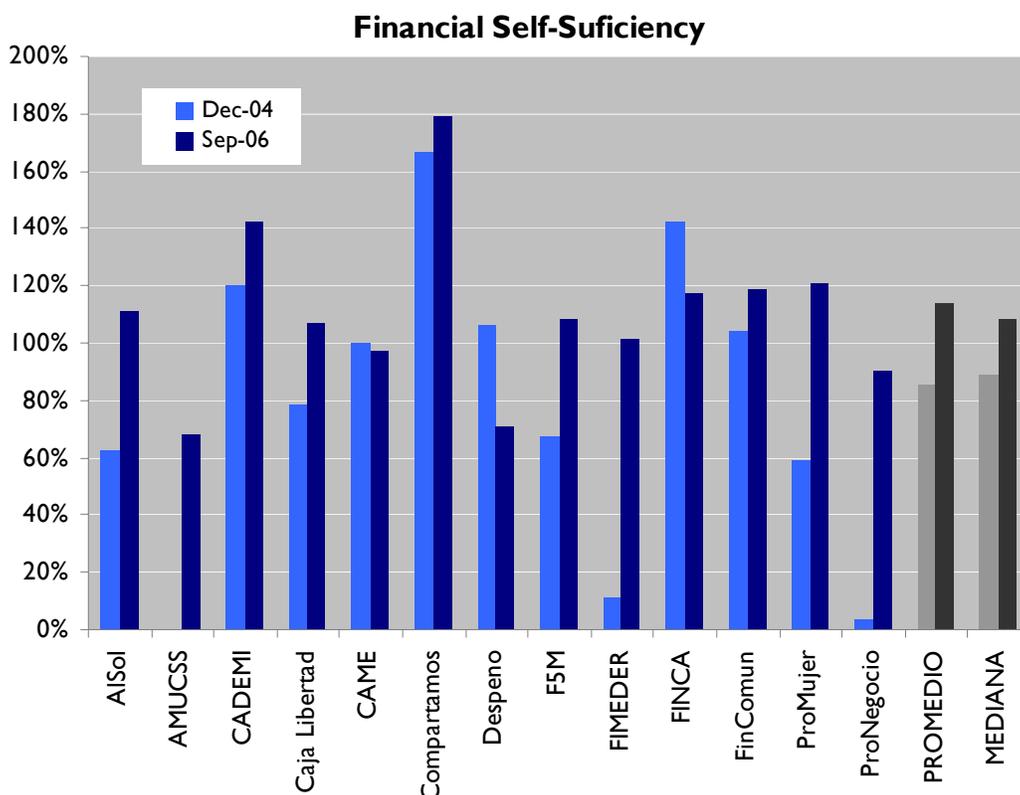
Compartamos' financial self-sufficiency increased, maintaining its position as one of Latin America's most profitable financial institutions. Both AlSol and ProMujer broke even in 2006 and improved steadily over the year. The baseline set for ProNegocio in June 2006 was 97%, and it has declined due to the adjustment for loan loss provisions. For the purpose of standardization, that adjustment is made despite the fact that ProNegocio has a guarantee to cover loan losses, and therefore is able to provision at a much lower rate than would otherwise be necessary and still meet CNBV standards.

Because standard calculations are used for this indicator, in which a single "market" rate of funding is applied to funding liabilities,¹¹ the adjustment varies depending upon the structure of the balance sheet and the actual cost of funding of each institution. For instance, this adjustment affects Caja Libertad the most because they mobilize funds at a rate significantly below the "market" rate AFIRMA uses, and this adjustment along with an adjustment for loan loss provisioning¹² results in a lower level of financial self-sufficiency.

¹⁰ The standard CGAP definition is applied: operating revenue (excluding donations) is divided by adjusted operating expenses, where adjustments are made for inflation, subsidized cost of funds, insufficient provisions, and in-kind donations.

¹¹ AFIRMA uses the average asset price percentage rate TIEE 28 published by the Banco de Mexico, 7.31% annual as of September 2006.

¹² CL provisions at rates lower than the CNBV standard for SOFIPOs and has a portfolio-at-risk over 30 days of 12%.



As the financial self-sufficiency chart shows, variance remains among the partners in terms of their ability to cover adjusted operating expenses with operating revenues, although there has been significant convergence. Relatively high levels of financial self-sufficiency have been attainable in Mexico due to continued **high levels of portfolio yield**, as shown in the portfolio yield ratio table below and the chart on the following page.

High portfolio yields reflect the high average interest rates charged to microfinance clients in Mexico, as compared to other countries in the region, where competition has reduced rates dramatically in recent years. The 30 MFIs that MicroRate tracks in Latin America had, on average, a portfolio yield of 37.6% as of December 2004, well below the average of 70.1% among 12 AFIRMA MFIs in June 2006. This rate is pulled down by Caja Libertad, a credit union that charges lower interest rates and has higher levels of non-performing loans (and considerably larger average loan sizes) which lowers the yield ratio. Despeno, AMUCSS, and ProNegocio all carry relatively high levels of non-performing loans on their books, which if written off would reduce the size of the portfolio thus increasing the yield ratio substantially. All 3 charge rates

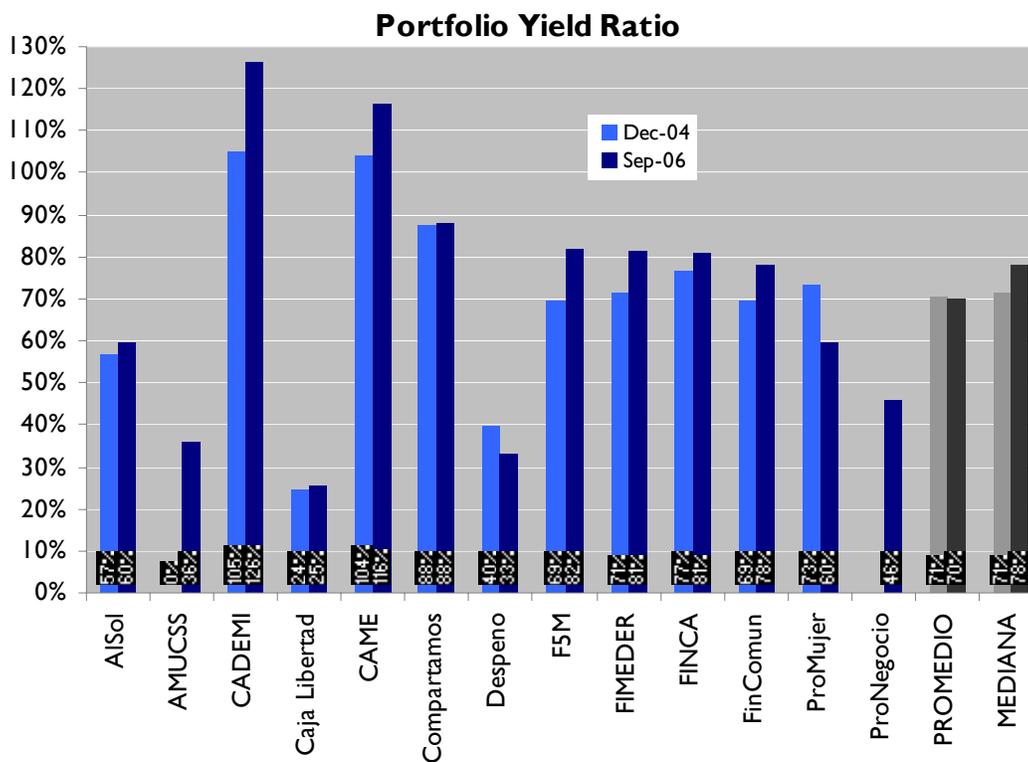
Table 6 – Portfolio Yield

MFI	Dec-2004	Sept. 2006
AISol	56.6%	59.7%
AMUCSS*	N/A	36.1%
CADEMI	104.8%	126.4%
Caja Libertad	24.4%	25.3%
CAME	103.8%	116.1%
Compartamos	87.7%	87.8%
Despeno	39.7%	33.3%
F5M	69.3%	81.9%
FIMEDER	71.1%	81.1%
FINCA	76.7%	80.8%
FinComún	69.3%	77.9%
ProMujer	73.4%	59.6%
ProNegocio	-	45.8%
Average (Excl. PN)	70.6%	70.1%

Preliminary AMUCSS data as of June 2006 shown here

comparable to other AFIRMA partners. Also, it is worth mentioning that the MicroRate averages are boosted by Compartamos and FinComún, the only representatives of Mexico among the MicroRate 30, which have the two highest portfolio yield ratios among that group.

ProMujer and AISol represent notable contrasts to the norm, as both maintain high quality portfolios, and the lower-than-average portfolio yields represent lower interest rates charged to clients. It is also worth noting that PMM is the only MFI in Mexico (known to AFIRMA) that both charges and quotes interest rates to clients on a declining balance. AFIRMA hopes that recent initiatives such as the Banco de Mexico norm to standardize calculation of the Total Annual Cost (*Costo Anual Total* – CAT) will spread to unregulated entities as well. The microfinance association ProDesarrollo has launched an important campaign in this respect, with all members agreeing to a code of ethics and transparency towards clients, which could help change this situation.



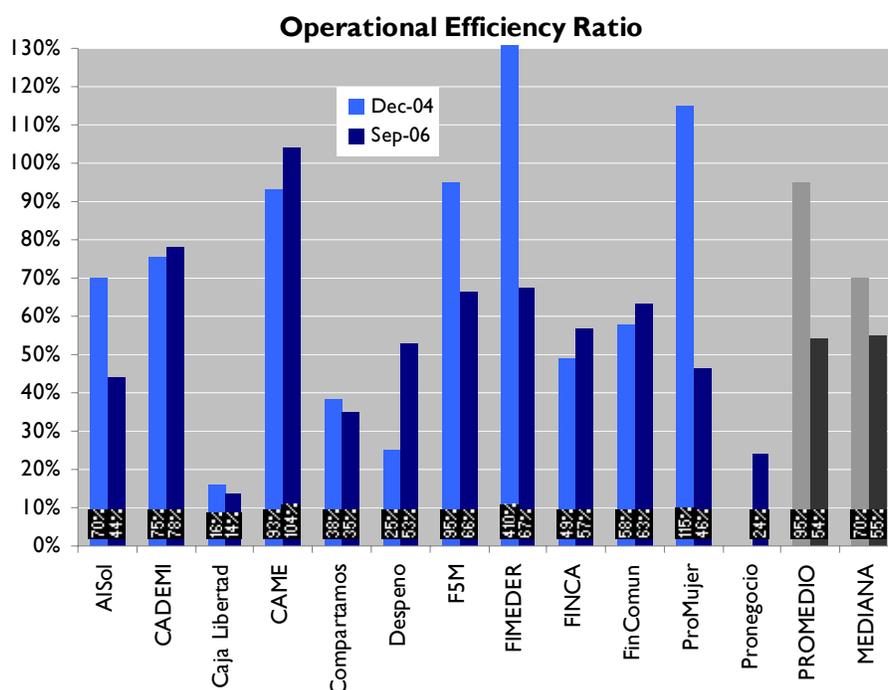
The high portfolio yields continue to cover inefficient cost structures, as reflected in the operational efficiency chart below, although efficiency improvements have led to the increased profitability mentioned above. The average operational efficiency has improved dramatically among the 11, due largely to the extremely high initial figure of FIMEDER which has improved with scale. Seven of 11 improved their efficiency as of September 2006, with AISol, ProMujer and Fondo 5 de Mayo (in addition to FIMEDER) making major improvements. The average operational efficiency (personnel and administrative expenses divided by average gross portfolio) of 54% remains well above (less efficient than) the regional average reflected in the MicroRate 30 of 19.1% as of December 2004. As with the portfolio yield ratio, the average operational efficiency ratio is pulled down by Caja Libertad, with its large portfolio and lower cost structure consistent with credit unions. Many of the other partners use the village banking methodology, which carries higher operating costs relative to the loan size than individual lending now predominant in the rest of the region.

Table 7 – Operational Efficiency

MFI	Dec-2004	Sept. 2006
AISol	69.9%	44.0%
AMUCSS	N/A	N/A
CADEMI	75.4%	78.1%
Caja Libertad	16.0%	13.6%
CAME	93.0%	104.1%
Compartamos	38.2%	34.9%
Despeno	25.1%	52.6%
F5M	94.9%	66.2%
FIMEDER	409.6%	67.3%
FINCA	49.0%	57.0%
FinComún	57.8%	63.3%
ProMujer	114.9%	46.4%
ProNegocio	24.1%	23.9%
Average (Excl. PN 12/04)	97.4%	54.3%

*PN calculated on a June 2006 baseline

This indicator will improve over time as partners gain scale, as greater emphasis is given to competition on service and cost, and, importantly, as staff productivity figures increase. Efficiency may become a key competitive factor in 2007 as increased competition among MFIs and with consumer lenders could put pressure on lending rates, and could potentially lead to deterioration in loan portfolios that are not well managed.



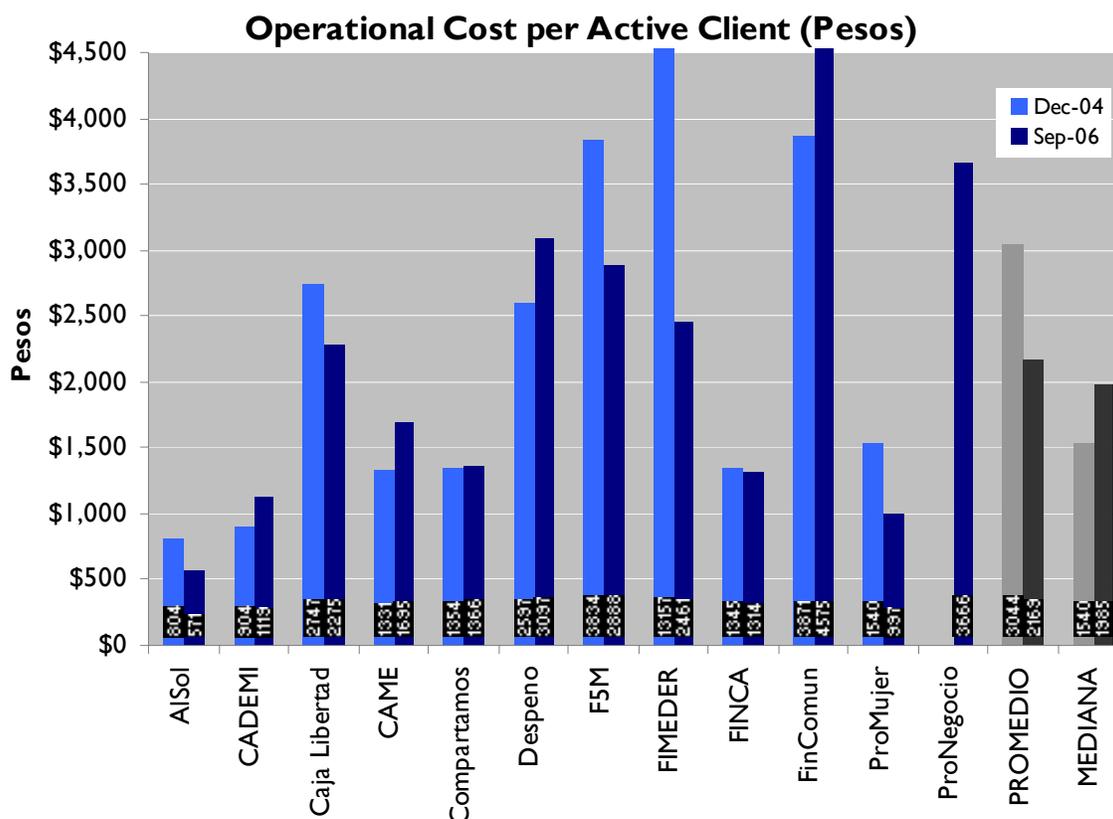
An important factor influencing the low levels of operational efficiency among AFIRMA partners is the **low average loan balance per client** in Mexico. One efficiency indicator that takes loan size out of the equation is the **cost per average active** client that the MFI serves.¹³ Various partners have efficiency figures more in line with international standards (MBB figures below) when measured with this indicator. AISol stands out in the table at right, which demonstrates why it can be profitable while serving clients with very small average loan balances. ProMujer has improved substantially by this measure as well.

In peso terms the MicroBanking Bulletin (MBB) averages for this indicator in Latin America, as reported in the August 2005 edition of the MBB are:

- All 52 MFIs: 1,597 pesos
- 8 Small MFIs (low income niche): 753 pesos
- 13 Large Financial Intermediaries: 2,544 pesos

Table 8 – Cost Per Client (pesos)

MFI	Dec-2004	Sept. 2006
AISol	804	571
AMUCSS		
CADEMI	904	1,119
Caja Libertad	2,747	2,275
CAME	1,331	1,695
Compartamos	1,354	1,366
Despeno	2,597	3,097
F5M	3,834	2,888
FIMEDER	13,157	2,461
FINCA	1,345	1,314
FinComún	3,871	4,575
ProMujer	1,540	997
ProNegocio		3,666
Average	3,044	2,169



¹³ Operating and administrative costs divided by the average number of active clients during the period.

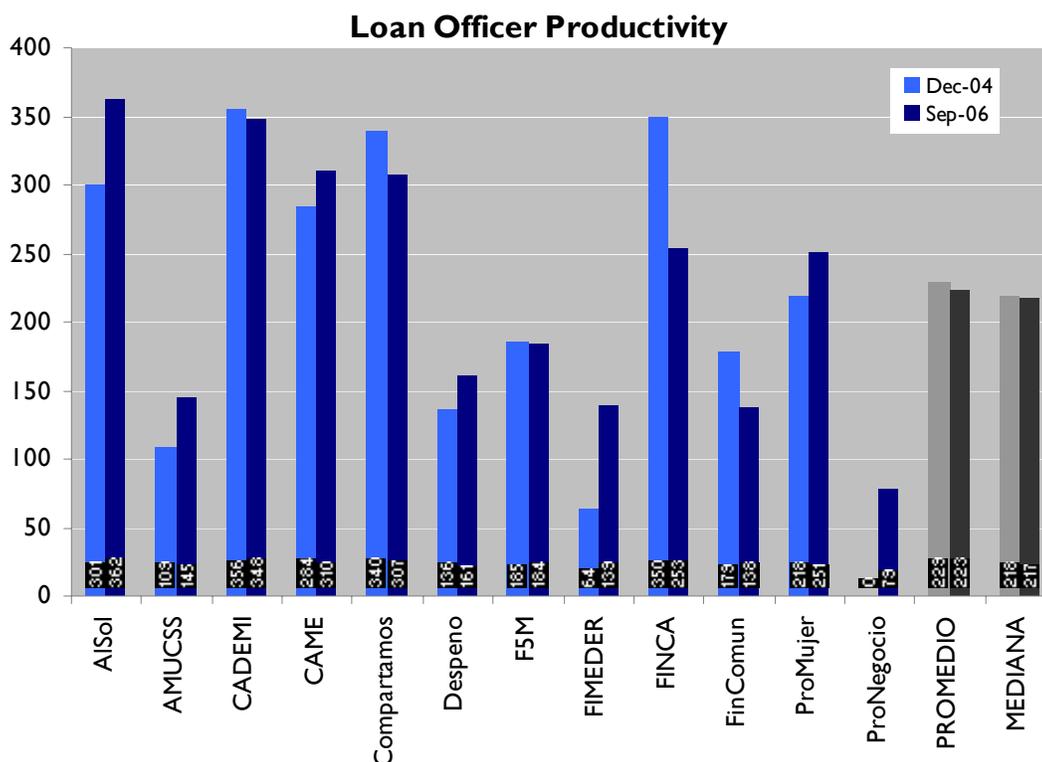
As shown in the **loan officer productivity** chart, still few of the AFIRMA partners reach international standard levels of loan officer productivity, although some have improved significantly. The average for the MicroRate 30 was 309 clients per loan officer as of December 2004, while the AFIRMA average was 223 as of September 2006 (not including Caja Libertad).

Productivity improvements at AISol and ProMujer, as well as increases at Despeno and FIMEDER (although still very low), partly offset declines elsewhere as FINCA, Compartamos, F5M and others are all in the process of hiring and training new loan officers that will take time to attain desired levels of productivity.

Caja Libertad, which had 1,425 credit clients per loan officer as of September 2006, is excluded from the average and from the table above since the traditional credit union lending methodology used there is not considered comparable with the other 12 partners.

Table 9 – Loan Officer Productivity

MFI	Dec-2004	Sept. 2006
AISol	301	362
AMUCSS	109	145
CADEMI	356	348
CAME	284	310
Compartamos	340	307
Despeno	136	161
F5M	185	184
FIMEDER	64	139
FINCA	350	253
FinComún	179	138
ProMujer	218	251
ProNegocio	-	79
Average (Excl. PN)	229	223



On average, AFIRMA partners maintain high quality portfolios, as measured by the indicator of **portfolio-at-risk over 30 days**¹⁴. Risk in the portfolio as of September 2006 for most AFIRMA partners was under control, although Despeno continues to carry non-performing loans related to on its books, the portfolio quality at Caja Libertad has deteriorated, and the quality of the ProNegocio portfolio is well below microfinance standards.

At Despeno, initial indications are that the recently-disbursed microfinance portfolio is performing well, contributing to improved results overall, although it remains to be seen what the effect is on the total portfolio going forward. If Despeno were to write off long-standing non-performing loans, the portfolio-at-risk over 30 days (PAR>30) would be roughly 4%.

Caja Libertad has a high PAR>30 rate when compared to MFIs and recent deterioration requires further analysis, although it should be pointed out that the portfolio reflects standard credit union lending to salaried workers, carrying much lower operational costs, but often higher loan losses than found among MFIs.

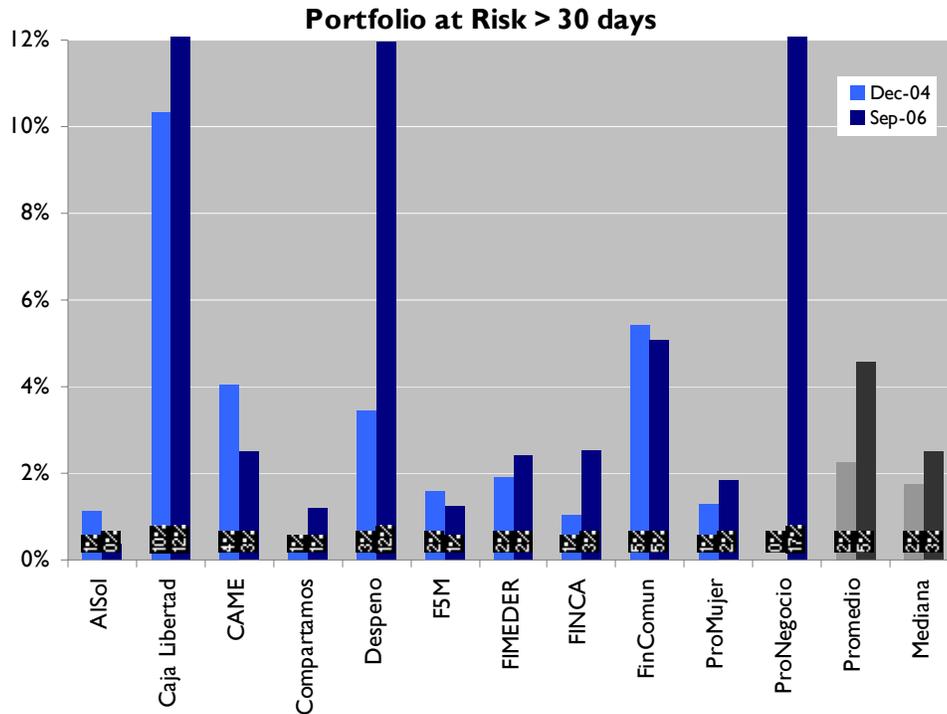
AFIRMA worked with FinComún to develop a comprehensive approach to risk management and to adjust the lending methodology to improve repayment rates.

CADEMI is not shown in the chart below since the MFI's current management information system does not allow for calculation of portfolio-at-risk. CADEMI uses arrears rates and AFIRMA will assist the MFI to make the change with the implementation of the new MIS. Based on the very low level of arrears, AFIRMA estimates that CADEMI has a PAR>30 ratio below 5%. AFIRMA is supporting the implementation of a new MIS that will allow for correct calculation of portfolio-at-risk. Despite rapid growth (which should tend to lower portfolio at risk ratio), ProNegocio, added in June 2006, maintains very high PAR>30 ratio, an area where AFIRMA will focus efforts in the coming quarters.

Table 10 – Portfolio-at-Risk > 30 days

MFI	Dec-2004	Sept. 2006
AI Sol	1.12%	0.38%
Caja Libertad	10.33%	12.12%
CAME	4.04%	2.50%
Compartamos	0.56%	1.22%
Despeno	3.47%	11.96%
F5M	1.58%	1.27%
FIMEDER	1.92%	2.42%
FINCA	1.03%	2.52%
FinComún	5.44%	5.09%
ProMujer	1.28%	1.82%
ProNegocio	-	16.62%
Average	2.3%	4.6%

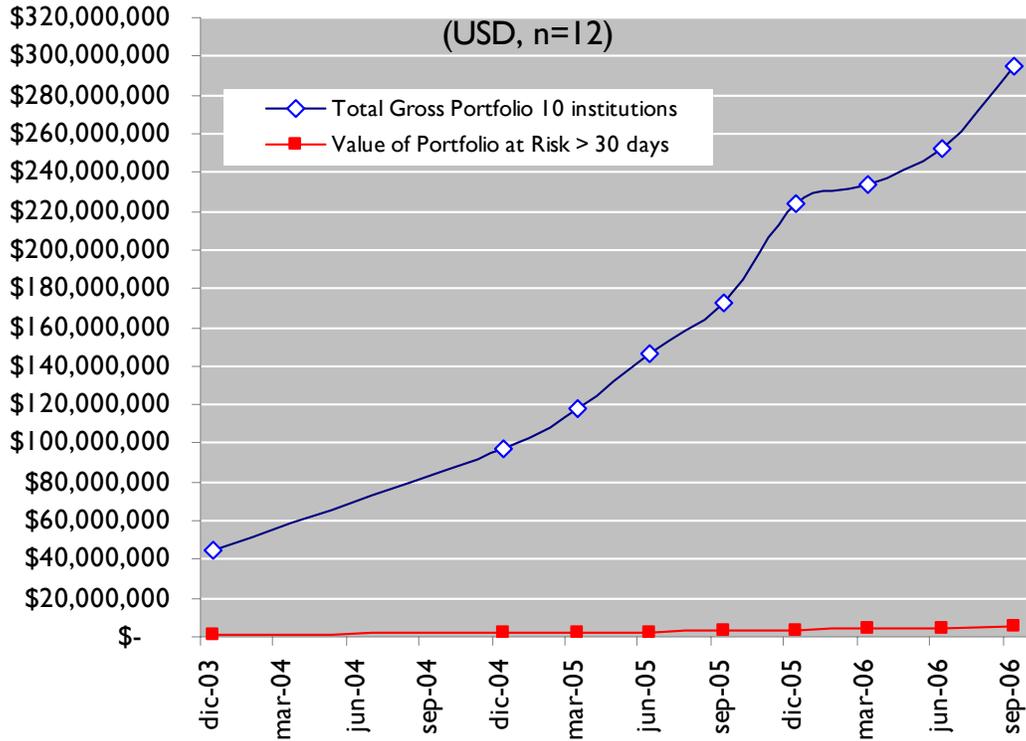
¹⁴ Total balance of loans in arrears over 30 days divided by the gross loan portfolio.



AFIRMA partners have, for the most part, avoided having to write-off significant portions of their portfolio, with the notable exceptions of CAME and FinComún, each of which have written off about 6% of their gross portfolios in 2006. Despeno will write off non-performing loans once it is able to establish loan-loss reserves, most likely in mid-2007.

The chart below also shows the entire portfolio of 12 AFIRMA partners (Caja Libertad is excluded) compared to the total value of the portfolios at risk over 30 days of those partners. The total value of the loan portfolios in September 2006 among these institutions was \$295,236,238 (USD) a 204% increase in dollar terms as compared to December 2004. Although the figures continue to be driven by Compartamos, which represents 65% of the total portfolio when Caja Libertad is not counted (28% when CL is counted). The chart reflects the high repayment rates consistent among clients of the project's partners.

Total Loan Portfolio and Value of PAR > 30 days



The aggregate portfolio at risk of the 12 institutions (not including Caja Libertad) was 2% in September 2006, as compared to 1.9% one year prior and 2.1% as of the baseline. If Caja Libertad is included, the figures rise significantly, to 7.5% as of the baseline in December 2004 and 9% in September 2006.¹⁵

Although most partners maintain high portfolio quality, the fast growth in lending, high write-offs in a couple of instances, recent deterioration in portfolio quality among large partners, and the ongoing lack of consolidated credit information (across credit bureaus, for instance) suggest that portfolio quality trends should be monitored carefully.

¹⁵ At \$431 million USD in March, the CL portfolio is larger than the rest of the AFIRMA partners combined, and portfolio quality, as discussed above, is well below average of the MFIs.

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