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DEEPENING MALAWI’S MICROFINANCE SECTOR PROJECT (DMS) FY 2008 ANNUAL REPORT

OCTOBER 1, 2007 – SEPTEMBER 30, 2008

<u>Opportunity International Bank of Malawi’s (OIBM) Mobile Bank</u>

October 31, 2008

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Abbreviations and Acronyms

AMAP	Accelerated Microenterprise Advancement Project
BDS	Business Development Services
CAMEL	Capital adequacy, Asset quality, Management, Earnings [and] Liquidity
CBF	Capacity-Building Fund
CBS	Capacity Building Specialist
CF&EE	Commercial Finance and Enabling Environment Specialist
CUMO	Concern Universal Microfinance Organization
CGAP	Consultative Group to Assist the Poor
COP	Chief of Party
DCA	Development Credit Authority
DEMAT	Development of Malawian Enterprises Trust
DFID	Department for International Development (Britain)
DMS	Deepening Malawi's Microfinance Sector Project
ECLOF	Ecumenical Church Loan Fund
FINCA	Finance for International Community Assistance
FITSE	Finance Trust for the Self-Employed (World Vision)
FSJTF	[European Union] Food Security Joint Task Force
GDA	Global Development Alliance
GoM	Government of Malawi
HIVOS	International Humanist Institute for Cooperation
IQC	Indefinite Quantity Contract
MAMN	Malawi Microfinance Network
MARDEF	Malawi Rural Development Fund
MFI	Microfinance Institution
MoA	Ministry of Agriculture
MoF	Ministry of Finance
MoITPSD	Ministry of Industry Trade and Private Sector Development
MOU	Memorandum of Understanding
MRFC	Malawi Rural Finance Company
MSB	Malawi Savings Bank
MSME	Micro, Small and Medium-size Enterprise
MUSCCO	Malawi Union of Savings and Credit Co-Operatives
NABW	National Association of Business Women
NASFAM	National Smallholders Farmers Association of Malawi
OIBM	Opportunity International Bank of Malawi
PMP	Performance Monitoring Plan
PMU	Project Management Unit
PRIDE	Promotion of Rural Initiatives and Development Enterprises
RAF	Rural Agricultural Finance
RBM	Reserve Bank of Malawi
SACCO	Savings and Credit Cooperatives
SALES	Support for Agriculturally Linked Enterprises
SEDOM	Small Enterprise Development Organization of Malawi
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme

I. EXECUTIVE SUMMARY

This is the fourth-year annual report for the Deepening Malawi's Microfinance Sector Project (DMS) implemented by Chemonics International (CI). This report covers the FY2008 project activities undertaken during the period October 1, 2007 – September 30, 2008. DMS is contracted by USAID/Malawi under the financial service component of the Accelerated Microenterprise Advancement Project (AMAP) Indefinite Quantity Contract (IQC). The Task Order #804 for this project was signed in September 2004 with a ceiling amount of $3,477,056. On September 21, 2007 the ceiling was increased to $4,529,538 and the ending date extended to September 30, 2009.

Over the past year turnover of field office staff was nil; all members have remained with the project since they were hired. Project leases and other administrative issues continue to be successfully handled without incurring any extraordinary costs to the project. At the same time, Chemonics' headquarters has provided effective backstopping support to the field office and competently handled all issues related to contracting and mobilizing short-term international consultants and firms who were engaged to carry out technical activities.

The overarching results framework objective in the original project statement of work remained largely unchanged through the extension period. DMS is expected to achieve a deepening of Malawi's financial sector through expanded access to sustainable financial services for micro, small and medium enterprises and low-income households by working through three project components:

- Improve the sustainability and outreach of MFIs through retail-level capacity building;
- Facilitate access to greater flows of commercial capital for financial intermediaries through targeted capacity-building, linkages and brokering;
- Contribute to a more enabling regulatory, supervisory and legal framework for microfinance.

Guidelines on best practices emphasize the importance of integrating financial services for the economically active poor into the overall financial system of a country. Such inclusive financial systems are most effectively supported by providing demand-driven assistance at the micro (retail-level financial institutions and other providers), meso (financial infrastructure), and macro (enabling policy environment) levels. DMS operates at each of these levels to eliminate constraints and build the institutional capacities of Malawi's micro, small and medium enterprise (MSME) finance sector.

For its first three years, the DMS project was the only "umbrella project" in Malawi that provided support to all three levels of the MSME financial sector. Last year DMS was joined by the Financial Inclusion in Malawi project (FIMA) that has a similar mandate. Start-up funding for FIMA was provided by UNDP and UNCDF with mechanisms in place for FIMA to bring in other donors willing to contribute to a "basket fund" for sector investments. Through the delegated authority of USAID, DMS plays an active role in FIMA by sitting on its Steering and Investment Committees and working closely with the FIMA project team to exploit synergies and leverage funding to achieve greater impact.

Over the past year, DMS maintained the scope and scale of project activities that it achieved in year three in terms of both number and variety of technical assistance activities carried out at all sector levels. At the micro level, DMS concentrated on the four microfinance institutions with which it signed memorandum of understanding in prior years that included: Finance for International Community Assistance (FINCA), Opportunity International Bank of Malawi (OIBM), Malawi Union of Savings and Credit Cooperatives (MUSCCO) and Promotion of Rural Initiatives and Development Enterprises (PRIDE). As of September 2008, these four institutions supplied 50% of all microcredit and 72% of all microsavings in Malawi. Over the life of the DMS project, OIBM, MUSCCO and FINCA have registered impressive gains in capacity and improved levels of operational sustainability as measured by their reported performance indicators. Each has also added new and improved financial service products for their clients that are much more demand-driven than those previously offered. However, only MUSCCO, its member SACCOs and OIBM can legally mobilize and on-lend savings deposits to clients in the form of loans that generate larger revenue streams and increase outreach and profitability. Other MFIs that are registered as trusts or companies limited by guarantee continue to struggle to build their loan portfolios as quickly as they would like. This situation should change when the Government of Malawi (GoM) successfully passes the new Microfinance Bill which the DMS project helped to draft that would open up a legal space for licensed deposit-taking MFIs.

An enormously significant change at the micro level over the past eighteen months was the entry into the Malawi microfinance market of the payroll lenders group. These are independent share holding companies that are privately funded and operate in multiple countries in Sub Saharan Africa. As of 30 September 2008 they captured more than 31% of Malawi's micro credit market with MK 2.7 billion (US$19.6 million) in loans outstanding, all privately financed.

At the meso and macro levels, DMS continued its activities to facilitate growth in promising but under-performing rural agricultural finance (RAF) value chains such as coffee, tea, cotton, paprika and dairy. DMS helped localize USAID's RAF workshop material and used it to launch seminars and value chain finance studies that exposed the full chain of actors to opportunities and constraints in their sub-sectors. Value chain businesses report that DMS's interventions have helped to remove information asymmetries present in the market that led to invalid assumptions on both the supply and demand sides of financial services. As a result, multiple examples of new financing taking place can now be seen. In the last year, DMS continued to develop linkages with other projects working in the agricultural sector and helped to leverage their activities through the introduction of financial services offered by banks and MFIs working with DMS.

Also last year, DMS worked closely with USAID to operationalize the US$13 million Development Credit Authority (DCA) multi-lender loan portfolio guarantee (LPG) facility that was designed the year before. This new LPG facility will run through September 2014 and targets agriculturally-linked MSMEs. It officially "opened for business" in December 2007 when Standard Bank met all of the conditions required and was given the green light by USAID to put loans under guarantee. DMS has provided specialized training and technical assistance to Standard Bank over the year to help it service the SMEs that have become a key target group for the bank. DMS also marketed the facility to other Malawi banks that expressed interest in joining the DCA Agreement.

At the macro level DMS played a central role in donor coordination meetings and decisions touching on the MSME finance sector. DMS took the lead to assist the GoM to draft new legislation for the microfinance industry by providing support to the Legal and Regulatory Taskforce chaired by the RBM to draft a new Microfinance Bill and a Financial Cooperatives Bill. Major contributions were made by the IRIS Center of the University of Maryland under contract to DMS and by the World Council of Credit Unions. Drafts of the Bills were sent to the Ministry of Justice for final edits and localization. Passage of the two Bills is expected at the sitting of Parliament immediately after the 2009 election.

Regarding project finance, the two-year funded extension through September 30, 2009 increased the DMS contract ceiling to $4,529,538 and the contract was fully obligated last year. As of 30 September 2008, $963,383 remains unbilled which will fund the fifth and final year of the project. DMS will need to decrease its average monthly billings to $68,036/mo over its final 12 months in order to adequately fund necessary close out costs.

II. ADMINISTRATION

Year four administrative activities achieved the following:

- Ensured that contract deliverables supplied to USAID were of a high quality;
- Recruited, contracted, and mobilized short-term consultants and subcontractors;
- Complied with Chemonics' and USAID's operating policies and procedures;
- Maintained effective and efficient communication channels between the home office project management unit (PMU) and the field office;
- Exercised tight budget control to remain within the two-year funded extension budget while at the same time matching expenditures to the timing of funding obligations;
- Managed project inventory, leases and all related administrative issues without incurring any extraordinary costs;
- Retained all field office staff and extended their contracts through the extension period.

A. PERSONNEL

The DMS field office technical team and support staff have remained intact throughout the project and employment contracts were extended in year three to coincide with the two-year project extension. The continuity of a competent staff has greatly contributed to the project's implementation. The technical team consists of Ezikiel Phiri as Commercial Finance and Enabling Environment Specialist (CF&EE), Teresa Maru-Munlo Capacity Building Specialist (CBS) and Victor Luboyeski Chief of Party (COP). They are joined by a locally-hired Office Manager/Accountant, driver and custodian.

Mr. Phiri, a Malawian with extensive banking experience both in and outside Malawi, joined DMS on March 13, 2006. He has positively impacted the project's technical efforts through his oversight of the work to improve and expand financial services along key agricultural value chains. He also leads the project's Development Credit Authority (DCA) loan portfolio guarantee program and DMS's work to assist the government of Malawi (GOM) to draft new microfinance legislation.

Ms. Maru-Munlo, a Kenyan citizen, has been with DMS since the start of field operations in December 2004. She has extensive, practical, microfinance experience in Sub-Saharan Africa and leads the project's microfinance institution (MFI) capacity building work. Besides providing support to other DMS technical activities, she has filled in as Acting COP whenever the need arises.

Mr. Luboyeski has led the project since its inception and backstops all project technical activities in addition to overseeing field office operations. He brings to the DMS Project more than thirty years experience assisting the development of micro, small and medium enterprises and leading economic growth activities in eight countries, four of which are in Sub-Saharan Africa.

The DMS field operations receive support from a three-person Project Management Unit (PMU) at Chemonics' head office. Of particular note is the fact that the PMU Director and PMU Project Manager have been with DMS since its inception, matching the stability of the field office team and contributing to the overall performance of the project.

B. LEASES & PROCUREMENT

The project leases office space in Lilongwe and living quarters for the COP. DMS's office includes a 1,000 m2 conference room that DMS and its local partners utilize for in-house training, debrief meetings and workshops. As a result, considerable time and money has been saved by avoiding rental of outside facilities and the same time, the profile of DMS has been greatly enhanced by being a central meeting place for sector activities.

The majority of DMS's office equipment was purchased in year one and supplemented by two vehicles and assorted office furniture that was transferred to DMS when USAID's SALES project closed in June 2006. In addition, the project procured an IT equipment upgrade for PRIDE Malawi's headquarters at a cost of approximately $60,000. This equipment remains a part of DMS's inventory. At the close of the project, DMS will make a formal request to USAID to transfer the goods to PRIDE.

III. TECHNICAL ACTIVITIES

The overarching objective of DMS is to deepen Malawi's financial sector serving MSMEs and to favorably impact the economic status and security of poor Malawian households. DMS operates in a context where approximately 65% of Malawi's 13 million population lives under the national weighted average poverty line and an estimated 85% reside outside urban centers.

DMS project methodology combines a finance sector approach with one that works along rural agricultural value chains. It is market-driven with a focus on building local capacity to improve core competencies and supporting the development of an inclusive financial sector that can sustain itself in the long run. Three levels of the MSME sector are targeted:

(1) **micro/retail level**: aiding high-potential MFIs to meet their goals of sustainability, outreach, and efficiency. Also, through the DCA loan portfolio facility, DMS works with commercial banks to provide "missing middle" finance to ag-related MSMEs;
(2) **meso level**: building financial sector infrastructure, especially through local/regional support structures and working with high value agricultural value chains and commercial finance intermediaries;
(3) **macro level**: aiding the establishment of an enabling environment for the development of an inclusive financial sector.

In its fourth project year, DMS matched its level of technical activities with the amount of USAID funding for project's two year extension. However, demand for assistance from partners continued to far outstrip available funds so the DMS technical team once again provided "in-house" expertise that made up a large part of the assistance provided to partners.

In FY2008, capacity building assistance targeted five institutions that signed memorandum of understanding (MOU) with DMS in prior years. These were: PRIDE, OIBM, MUSCCO, FINCA and the meso level Malawi Microfinance Network (MAMN). In deciding which MFIs to support, DMS developed a tiered approach along sustainability and outreach lines that gave greatest weight was given to institutions committed to implement best practices, charge full-recovery interest rates and fees, adhere to transparency in reporting, operate as specialized financial institutions, comply with USAID reporting requirements and agree to cost-share on the assistance provided by DMS. Before providing technical assistance, the institutions is assessed and an MOU is signed that identifies the technical assistance desired. Scopes of work of individual technical assistance activities are jointly developed with the MFI and the selection of service providers are mutually agreed-upon, with preference given to local consultants and firms.

In addition, DMS supported the sector's development by working closely with key government ministries, the Reserve Bank of Malawi (RBM), other donors, and agricultural value chain actors.

Technical assistance was provided through a combination of direct assistance delivered by the DMS technical team and supplemented by short-term contracts issued to consultants and/or firms and sponsorship to attend a select number of regional training opportunities.

The technical section of this annual report is organized into activities taking place at the micro, meso, and macro levels. Progress made at all three levels is described in detail below.

A. MICRO LEVEL

The DMS approach to building microfinance institutional capacities at this level consists of a combination of targeted technical assistance, customized training, generic best-practice training and institutional assessments. A table listing the leading microfinance institutions, their legal status and market share as of the close of FY2008 is found below.

Table 1: Malawi Microfinance Market Share (Specialized Financial Service Providers)

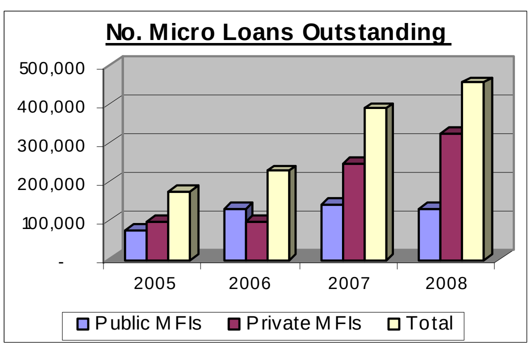
MICROFINANCE MARKET SHARE (at 30 September 2008)							
MF Providers	**Legal Status**	**Savings / Cash Collateral**			**Loans**		
		Number	**Value (MK)**	**% (value)**	**Number**	**Value (MK)**	**% (value)**
Govt. of Malawi Entities							
MARDEF*	GoM Project	-	-	0.0%	105,015	694,162,819	7.9%
MRFC*	Corporation	223,188	531,916,401	6.4%	4,487	358,212,476	4.1%
PRIDE	Corporation	14,483	53,983,668	0.7%	9,470	233,024,714	2.6%
SEDOM	GoM Trust	2,041	1,349,684	0.0%	10,970	151,000,000	1.7%
DEMAT	GoM Trust	1,335	3,743,573	0.0%	962	20,966,278	0.2%
MSB	Corporation	181,024	1,772,841,727	21.4%	87	10,187,742	0.1%
GOVT. of MALAWI TOTAL		***422,071***	***2,363,835,053***	***28.5%***	***130,991***	***1,467,554,029***	***16.7%***
Private Sector Entities							
OIBM	Licensed Bank	179,340	4,328,300,951	52.2%	28,550	2,781,089,281	31.6%
MUSCCO	Cooperative	80,027	1,456,831,524	17.6%	171,235	1,113,300,000	12.7%
FINCA	Corporation	15,556	111,157,000	1.3%	16,348	306,241,044	3.5%
CUMO	Corporation	32,012	25,491,619	0.3%	32,583	121,966,013	1.4%
MicroLoan	Corporation	-	-		9,234	97,255,480	1.1%
Coffee SACCOs	Cooperative	670	535,734	0.01%	1,714	51,686,386	0.6%
ECLOF	NGO	-	-		3,875	43,680,955	0.5%
FITSE	Trustee Act	-	-		4,054	25,060,000	0.3%
Touching Lives	Corporation	1,314	1,988,971	0.02%	1,314	11,706,425	0.1%
Hunger Project	Project	1,110	1,206,868	0.01%	3,917	11,189,201	0.1%
Citizen Loan Plan	Corporation	-	-		242	4,607,100	0.1%
NABW	Trustee Act	986	1,968,495	0.02%	685	2,740,241	0.03%
Subtotal		***311,015***	***5,927,481,162***	***71.5%***	***273,751***	***4,570,522,126***	***51.9%***
Private - Payroll Lenders Group							
Payroll Lenders	Corporation	-	-		50,437	2,760,257,558	31.4%
PRIVATE SECTOR TOTAL		***311,015***	***5,927,481,162***	***71.5%***	***324,188***	***7,330,779,684***	***83.3%***
GoM + Private Sector TOTAL		**733,086**	**8,291,316,215**	**100%**	**455,179**	**8,798,333,714**	**100%**
Value @ MK141 / USD			**$58,803,661**			**$62,399,530**	
** MARDEF loans outstanding are as of 30-Jun-2008*							
** PRIDE cash collateral collected is reported as of 30-Jun-2008 whereas loans are at 30-Sep-2008*							

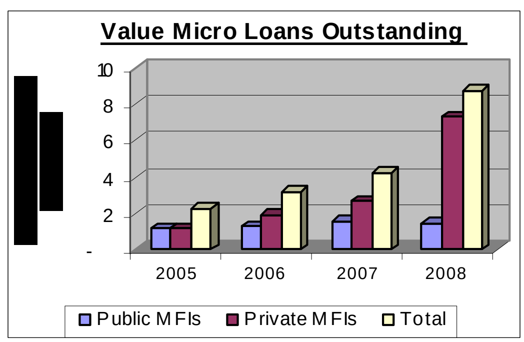
Up until a few years ago, the micro level of retail MFIs in Malawi consisted of wholly-owned government entities plus a small number of specialized MFIs and savings and credit cooperatives (SACCOs). However over the past four years there has been a dramatic shift in MFI market share among previous players as well as the entry of new entities that has led to an enormous deepening and broadening of the microfinance sector.

For example, at the start of the DMS Project in January 2005, the total number of micro loans outstanding in the sector were 175,583 valued at MWK 2.28 billion (USD $18.25m). Of these, 57% were supplied by public sector entities. Also at that time, micro savings/cash deposit accounts at MFIs totaled 392,341 and the value of these was MWK 1.8 billion (USD $14.5m), 44% of which were with public sector entities.

Since the DMS start-up, the microfinance sector has seen remarkable growth that was led by private sector entities that now account for 71.5% of the savings/cash deposits mobilized and 83.3% of the microloans outstanding. (Table 1) Overall, in less than four years the Malawi micro savings and micro loans portion of the formal financial sector has grown by 457% and 386% respectively. This is a remarkable achievement that has proven true USAID's assumptions at the start of DMS: (1) that there existed in Malawi a large demand and supply gap for microfinance services and (2) the best way to close the supply and demand gap was through private sector investment in professionally run financial institutions. The previous dependence on non-deposit taking government entities and partially transformed revolving loan projects run by NGOs and capitalized with donor funds have proven to be unsuccessful at achieving scale and building an inclusive financial sector in Malawi.

The growth progression in micro loans furnished by private and public sector entities since January 1, 2005 and September 30, 2008 is shown in Graphics 1 and 2 below. It is interesting to note that other than the launch in 2006 of the Malawi Rural Development Fund (MARDEF) by the Government of Malawi (GoM) which capitalized it with MWK 1 billion (USD $7.4 million), the public sector provision of micro loans has been stagnant. On the other hand, the start-up during this time period of the privately-owned Opportunity International Bank of Malawi (OIBM), financed in large part by USAID and DFID, coupled with the introduction in 2007 of several private companies targeting the public sector payroll loan market has accounted for nearly all of the growth seen in the micro credit sector. Adding to these, the Malawi Union of Savings and Credit Cooperatives (MUSCCO) performance is also noteworthy as the value of micro loans issued by its member SACCOs increased over this four year period by nearly 300% to MWK 1.1 billion (USD $7.9 million).

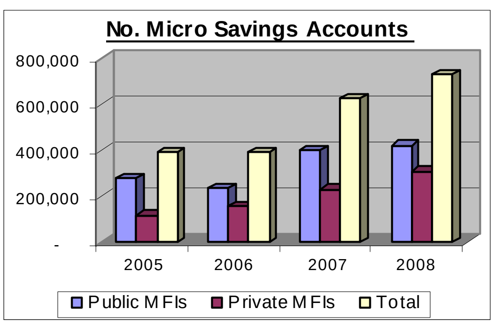


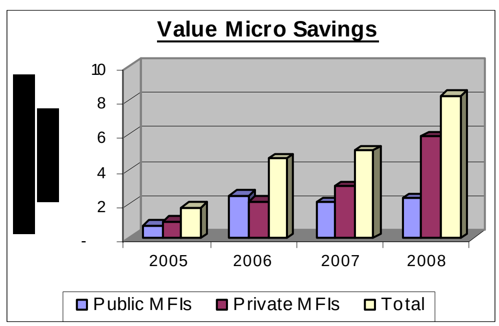


Graphics 1 & 2: Growth in Micro Loan Numbers and Values

The payroll lenders group noted above consists of Blue Financial Services Ltd, Greenwing Capital Ltd, Izwe Loans, Pelton Finance and Select Finance. These five companies now account for 31.4% market share with 50,437 borrowers and MWK 2.7 billion (USD $19.7 million) in loans outstanding. The first to operate in Malawi was Blue Financial Services starting in July 2007 followed by Greenwing in August 2007. Izwe, Pelton and Select opened after August 2008. All have corporate headquarters located outside Malawi and are pursuing aggressive expansion plans to open up new operations throughout Africa. Their business model in Malawi is to provide same-day approval of payroll loans with deduction at the source by the employer. By operating through national employers, such as the GoM, they are able to extend loans deep into rural areas where traditional MFIs have difficulty operating, and can do so at a fraction of the cost of traditional MFIs due to a repayment arrangement that does not require personal contact with the borrower once the loan is disbursed. Although not all payroll lenders capture data on the use of the financing they provide, those that ask borrowers what they intend to do with the loan report that more than 50% of the loans are used to finance some sort of economic activity. As a whole, the payroll lender group proves that privately funded microfinance companies can help to close the gap between microfinance supply and demand and do so sustainably. As the number of competitors entering the market increases, the cost of finance decreases. And, the number of loan products will also increase as some payroll lenders are studying the possibility of introducing new loan products to the market, such as housing and SME finance.

The growth trend in total micro savings is similar, though the differences between public and private sector are less pronounced. The reasons for this are primarily due to the nature of the savings deposits mobilized. Only licensed commercial banks or companies granted exemptions by the Reserve Bank of Malawi (RBM) are able to collect savings deposits. OIBM and Malawi Savings Bank (MSB) are the only licensed commercial banks that specifically target micro savers. Since the start of DMS, the value of savings mobilized by OIBM has increased from MWK 313 million (USD $2.2 million) to MWK 4.3 billion (USD $30.9 million) while MSB has increased its savings deposits from MWK 500 million (USD $3.6 million) to MWK 1.8 billion (USD $12 million). Only one non-licensed bank has been given an exemption by the RBM to mobilize but not intermediate savings and that is the Malawi Rural Finance Company (MRFC), a GoM-owned company limited by guarantee. MRFC's deposits have increased from MWK 303 million (USD $2.1million) to MWK 532 million (USD $3.8 million). Another large private sector contributor to the growth in savings was the MUSCCO. Savings deposited at its SACCOs grew from MWK 535 million (USD $3.8) to MWK 1.46 billion (USD $10.4 million). Since other MFIs focus is on loans, the client "savings" they record are actually mandatory cash collateral guarantees against loan default and therefore show little year-to-year growth on their own.





Graphics 3 & 4: Growth in Micro Saving Accounts Numbers and Values

In addition to loans issued by the institutions listed in Table 1, a sizeable amount of microcredit is issued by non-specialized sources such as estate growers, input suppliers, wholesalers, and commodity buyers to name a few. These loans are usually in the form of in-kind credits and/or payroll loans whereby the loan is repaid by cash deduction at the time the agricultural production is sold or salary payments made. This type of Micro Level financing and DMS's work to improve the efficiency of such transactions will be covered in the Meso Level section of this report under a description of the project's value chain work.

A.1 SECTOR-WIDE MFI CONTACT

DMS meets regularly with all major providers of microfinance in the country through individual meetings, stakeholder gatherings and other events. These occasions provide opportunities for the DMS team to disseminate information on best practices and provide expert technical advice on major internal and external challenges facing the sector. Last year's sector-wide discussions and stakeholder meetings were dominated by the work of the Microfinance Legal and Regulatory Taskforce chaired by the RBM which received DMS assistance to draft changes to the legal, regulatory, and supervisory framework for microfinance. (See Section C - Macro Level)

The bulk of DMS's direct MFI capacity building work was with our major partners with whom DMS signed Memorandum of Understandings (MOU): FINCA, PRIDE, OIBM, and MUSCCO. In addition, DMS met periodically with senior management from Concern Universal Microfinance Organization (CUMO), Ecumenical Church Loan Fund (ECLOF), Development of Malawian Enterprises Trust (DEMAT), Small Enterprise Development Organization of Malawi (SEDOM), and Malawi Rural Finance Company (MRFC). As all of these institutions are members of MAMN, they also benefited from training offered through the network as well as value chain meetings and credit supply and demand reports that DMS sponsored that capture and disseminate market intelligence to help to deepen Malawi's financial sector. In addition, DMS initiated a dialogue with the new MFI entrants to the Malawi market, the payroll lending group, mentioned above. The purpose of those discussions was to learn more about the payroll lenders' current and planned activities as well as to encourage them to join MAMN and actively participate in industry-wide stakeholder meetings.

Listed below are details of DMS technical activities that were carried out for individual MFIs with which we have signed MOUs.

FINCA Malawi

FINCA was the first institution to receive DMS assistance in project year one. Since then, FINCA has made remarkable progress implementing a turn-around program led by its parent, FINCA International, with technical assistance funded by DMS. Over the past four years it successfully revamped operations and product lines, closed non-profitable offices and opened others in high potential areas. It has recruited a new top management team in the positions of Finance Director, Operations Manager and Managing Director who now perform at a high level.

In line with its drive for commercial performance, over the past two years FINCA released a number of staff who were not achieving objectives. At the same time it instituted a new incentive scheme and performance monitoring plan to retain quality personnel and boost performance, efficiency, and morale. In 2008 eighteen village bank loan officers left FINCA, of these nine were dismissed for non-performance and seven joined other firms. As for business loan officers, a total of ten left as competitors hired two, other firms hired three and five were released for non-performance. Although staff dismissals carry the burden of severance payment, FINCA has decided that the cost of inaction is even greater in terms of loan losses and erosion of staff morale and productivity.

Graphic 5: Village Bank Meeting - FINCA

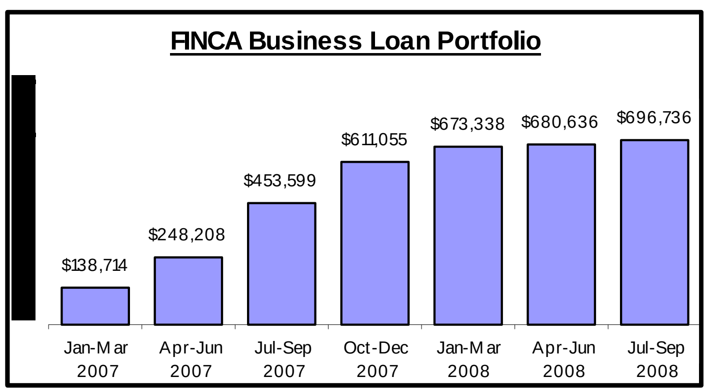
To help reduce voluntary staff turnover, in FY2008 FINCA purchased an human resource software that tracks recruitment, probation, performance appraisal and exit and to help it reduce fraud and improve performance, FINCA regularly rotates branch managers and holds quarterly regional meetings to review actual performance versus budget by profit centers.

DMS has supported FINCA's reengineering process through direct technical assistance delivered by the DMS Capacity Building Specialist (CBS), FINCA staff members who DMS trained plus various outside consultants and firms contracted by DMS to carry out specific assignments. FINCA International claims that without DMS's support, its restructuring plan for Malawi would not have succeeded. Specific details on activities supported by DMS in FY2008 can be found below.

Supervisor Training DMS provided cost-shared training of newly-promoted credit supervisors over four sessions, the last taking place in November 2007. Twenty-three participants were drawn from fourteen branches and included regional managers, supervisors and a number of loan officers identified for promotion. FINCA senior staff led the training with the CBS co-facilitating. The training content was developed by the CBS when she led the initial training at FINCA three years ago and included the following topics:

- Branch Performance Analysis
- Microfinance Best Practices
- Communication & Team Building
- Time Management
- Supervision & Personnel Management
- Information Management

Business Loan Training Business loan is the term FINCA uses to describe its individual loan product that was designed and introduced to the market with DMS assistance over the past two years. Targeting a different business owner than FINCA's typical group loan client, business loans attract entrepreneurs whose financing needs are usually larger and often include capital asset purchases. Many business loan clients are either not attracted to group loan schemes or have left groups when they found that their financing needs were not met by the group loan methodology. Because of these differences, FINCA's business loan officers receive specialized training before working with individual loan clients.



Graphic 6: FINCA Business Loan Portfolio Growth

As seen in Graphic 6, the business loan portfolio grew rapidly in its first year of introduction. Thereafter however, the portfolio stabilized at around US $700,000 when FINCA made a conscious decision to slow the growth to ensure that its loan quality target was met after it began to see deterioration in repayment. By focusing on close monitoring of clients with loans and carefully scrutinizing all new applications, FINCA has been able to keep its business loan portfolio at risk to an acceptable level and avoid disasters it met in previous years when it would have been tempted to increase a new product portfolio too rapidly despite early warning signs to slow down.

To help ensure that its business loan officers were properly trained, DMS helped FINCA to hold a training for business loan officers last March and April. Over a twelve day period, twenty-two were trained, including eighteen loan officers and three supervisors, most of whom were previously assigned to village banking products but were expected to transfer to work exclusively on business loans. As usual, the cost of the training was shared between FINCA and DMS with FINCA covering 40% of the cost while DMS covered 60%. FINELINE Kenya led the training which was a combination of classroom discussions and field work exercises to encourage practical application of the lessons. The course had the following objectives:

- Transfer knowledge and skills in sound banking practices to identify, assess and retain business loan customers;
- Develop proper attitudes, knowledge and skills to operationalize business loan products;
- Assist participants to identify suitable and accessible collateral alternatives;
- Impart knowledge and skills to increase portfolio size and improve loan quality;
- Increase loan officers' and branch managers' capacity to supervise business loan operations.

Training Needs Assessment In addition to the Business Loan training, FINCA and DMS conducted a mid-year training needs analysis and designed a management development training program that will be implemented by FINCA staff with assistance furnished by DMS through its CBS. The training plan is intended to prepare junior managers for promotion while improving existing management performance. FINCA expects that the implementation of the plan will help ensure that staff capacity building through training will be less ad hoc and more methodical, responsive to real needs and given a higher priority by top management in its annual work plans.

PDA Pilot Project As technology becomes more and more critical in managing MFI growth and risk, FINCA, with support from its Africa regional office, developed plans to equip its entire field credit staff with personal data assistants (PDA) to help report loan disbursements and repayments in real-time and improve the turnaround time on loans. The PDAs will also assist management to monitor and act timely to correct decreases in portfolio quality. DMS agreed to support a pilot study with the purchase of 20 PDAs and related IT hardware as well as support the cost of cabling FINCA offices in Blantyre and Lilongwe. FINCA will pay the cost of training and needed software upgrades to its current system. The project is expected to be up and running by December 2008.

Performance Indicators FINCA's performance indicators (PI) over the last year reflect its commitment to improving its bottom line by controlling costs and investing in competent people and profitable branches. Of particular note is the improvement in PAR which dropped to 5.3% in the last period due in part to the writing-off of 3,916 loans that were greater than 180 days past due. Although this action reduced the number of loans outstanding by 19%, the value of loans only decreased by 4% since borrowers' cash collateral guarantees were applied to repay loans in arrears. Additional discussion on FINCA PIs is found in the Monitoring and Evaluation Section of this report.

Selected PIs - FINCA	Oct 07 - Dec 07	Jan 08 - Mar 08	April 08 - Jun 08	July 08 - Sep 08
# of Loans Outstanding	21, 170	21,228	20,226	16,310
Value of Loans Outstanding (USD)	$ 2,206,621	$ 2,382,659	$ 2,267,061	$ 2,179,324
Total # of Cash Guarantees	20,423	20,395	20,226	16,310
Value of Cash Guarantees (USD)	$ 997,418	$ 877,374	$ 970,873	$ 946,796
Portfolio at Risk	11.5%	15.3%	11.5%	5.3%
Return on Assets	-15%	-22%	-9%	-7%
** Loan Portfolio in MK converted to USD at 140.5 MK/USD*				

Table 2: FINCA Selected Performance Indicators

MUSCCO

MUSCCO is Malawi's only apex savings and credit cooperative. It is made up of 66 Savings and Credit Cooperatives (SACCO) dispersed throughout the country that account for roughly 18% of all microsavings mobilized and 13% of all microloans outstanding in the sector. MUSCCO develops and leads training sessions, underwrites savings and credit insurance on SACCO products and conducts annual internal audits of its members. It also operates a central risk facility that intermediates deposits from SACCO's holding excess liquidity and on-lends the funds to SACCOs unable to meet their members' credit demand on their own.

Revised SACCO Governance and Accounting and Finance Manuals MUSCCO noticed that many SACCOs were struggling to achieve the same high standards with regards to financial management and governance, especially when there were changes in management and boards. Upon closer examination it was determined that a key source of the problem was the lack of updated operating manuals, which led to confusion over roles and responsibilities and an over-reliance on individual capacities instead of written policies, procedures and control systems.

To correct this problem, DMS issued local tenders won by O&M Consultants and Afro Management Consultants to evaluate existing SACCO manuals and develop a revised and harmonized Governance Manual and Accounting and Finance Manual that would be adapted by all SACCOs. Their initial assessments uncovered the following weaknesses, all of which were eliminated in the revised manuals:

SACCO accounting and financial management manual (old)
- Frequent inadequate staffing levels at SACCOs led to little or no segregation of duties and delays in ledger updates;
- Too many documents used to record the same transactions;
- Design and format of documents limited the accuracy and consistency of records;
- Insecurity of documents;
- Use of incremental budgeting led to frequent over or under expenditures;
- Maintenance of single bank accounts where multiple accounts were needed.

SACCO governance manual (old)
- Not all board members were aware of the existence of the "old" manual;
- The old manual contained unnecessary information and was difficult to follow;
- Old manual varied widely from SACCO to SACCO;
- The manual did not adequately provide direction to the various management committees.

After the new manuals were drafted, they were reviewed by DMS and a core team of senior executives from MUSCCO and selected SACCOs. Once final revisions were made, the Manuals were field tested at a handful of SACCOs before being rolled out to all SACCOs over the next year.

Revised MUSCCO Accounting and Finance Manual Following the highly successful effort to revise SACCO manuals, MUSCCO requested help to review and revise its own Accounting and Finance Manual in order to improve and streamline issues of accounting and budget management. The work was paid for by DMS and carried out by O&M consultants. It was completed in September 2008 and MUSCCO's Finance and Administration Manager Mr. F Nyangulu reported the exercise had exceeded MUSCCO's expectations as it immediately began to implement changes in accounting policies and procedures, even before the final manual was completed.

SMARTRAC Project MUSCCO requested DMS for assistance to help co-finance a technical assistance intervention implemented by the Triodos Bank and known as SMARTRAC (Sustainability, Management, Assurance, Risk, Transparency and Compliance). The overall objective achieved by the SMARTRAC consultancy was to institutionalize risk management at the strategic level and structure risk management in MUSCCO by setting up a systematic approach, policy and department to identify measure, monitor and manage business risks. A key outcome of the work was to draft a Risk Management Policy and Terms of Reference for the Head of the Risk Management Department that included defining how the Department would interact with management and the board to ensure that it was properly integrated within the organization. This risk-management consultancy complemented DMS's support for the revision of MUSCCO's Finance and Accounting Manual.

The 2007 Savings and Credit Cooperatives Africa (SACCA) Congress The SACCA Congress is an annual event that brings together primary SACCOs and networks from across Africa. The 2007 SACCA Congress was hosted by MUSCCO in Blantyre from 29 October – 2 November 2007. DMS played a key role by being a member of the Congress steering committee as well as supporting some conference costs. More than 380 participants from 10 countries attended and heard a variety of international experts discuss topics of mutual concern. In Malawi this included a presentation by the RBM on the draft Financial Cooperatives Bill that DMS funded.

Due Diligence Exercise DMS assisted MUSCCO to develop a tool to carry out due diligence exercises at SACCOs in support of MUSCCO's strategic plan to assist in the transformation and modernization of its SACCOs. This activity was jointly undertaken "in-house" by DMS technical specialists and MUSCCO staff. The final tool was pilot tested at six SACCOs in August and September by MUSCCO and DMS. After minor adjustments, it will be rolled out to assess all SACCOs during the first half of FY2009.

MIS Improvement Another area of assistance provided by DMS helped MUSCCO to optimize its MIS to better collect, organize, access and distribute data on its SACCO members. Preliminary reports from SACCO Chapters using the new data collection tools were very positive, showing marked improvements in the quality and timeliness of data collected. At the close of the year, MUSCCO was in the process of implementing the changes network-wide.

Performance Indicators The table below shows trends in key performance indicators at SACCO members over the year. Of particular note are the 16% increase in value of loans outstanding, the 30% increase in savings deposits and the reduction in PAR to 3% at September 2008. Additional discussion of MUSCCO's PIs is found in the Monitoring and Evaluation Section of this report.

Selected PIs - MUSCCO	Oct 07 - Dec 07	Jan 08 - Mar 08	April 08 - Jun 08	July 08 - Sep 08
# of Loans Outstanding	238,532	255,123	198,493	171,235
Value of Loans Outstanding (USD)	$ 6,803,492	$ 7,385,665	$ 8,204,682	$ 7,923,895
Total # of Deposits	74,226	73,849	78,146	80,027
Value of Deposits (USD)	$ 7,840,700	$ 8,556,336	$ 9,282,854	$ 10,368,908
Portfolio at Risk	4.0%	4.0%	5.0%	3.0%
Return on Assets	7%	5%	3%	5%
** Loan Portfolio in MK converted to USD at 140.5 MK/USD*				

Table 3: MUSCCO Selected Performance Indicators

OIBM

OIBM received its commercial banking license in May 2003 with a mission "To deepen access to banking services for the poor in Malawi who would otherwise lack access to any banking system." OIBM is part of the Opportunity International Network which is U.S.A.-based and operates in 31 countries. OIBM received start-up grant assistance from USAID/Malawi and DFID and supplemented that with recent investments from the Bill and Melinda Gates Foundation, AFRICAP and others.

DMS's assistance to OIBM in the past year consisted mostly of direct assistance delivered by DMS technical staff through consultative meetings with OIBM senior and mid level managers in support of OIBM's expansion of financial services to MSMEs. OIBM has been a regular fixture at DMS-sponsored rural agriculture value chain meetings and workshops and has benefited by the project's generation and dissemination of market information as seen in its expansion of financial services in the tea, coffee and dairy sectors to name a few. Specific capacity building assistance provided by DMS over the last year is further detailed below.

DCA Facility
In FY2007 OIBM expressed a desire to join the USAID/Malawi Development Credit Authority loan portfolio guarantee facility that targets ag-linked small and medium enterprises. However, since OIBM was a relatively new bank at the time, it had not yet developed a strong enough track record to qualify. In FY2008 OIBM reiterated its interest to join and worked with the DMS team to provide all of the necessary documentation needed for consideration. In August OIBM received approval from the DCA Credit Review Board to join the pre-existing multi-lateral DCA agreement and thereby access up to US$2 million in loan guarantees. At the close of the year, OIBM was awaiting final draft of the Agreement for signature.

Regional Workshops and Conferences DMS co-sponsored an OIBM supervisor to attend the MicroSave SAM 2008 training in Kenya in September and also co-sponsored the Head of Credit of OIBM's Limbe Branch to attend a specialized strategic planning course known as Microfin that took place in August in South Africa. Based on follow-up reports from OIBM, the participants have disseminated information on their training to colleagues through in-house training sessions and meetings in their respective departments.

Performance Indicators Selected performance indicators for the last year are found in the table below. Of note is the continued extraordinary growth in savings deposits over the course of the year (2.7 times). This is largely due to the fact that OIBM faces little competition in the Malawi micro savings market due to the scarcity of institutions with the legal right to intermediate savings and which focus on the microfinance market. Although the number and value of loans outstanding also increased enormously, there was a widening margin between the value of savings mobilized and the value of loans outstanding. This trend, also seen in previous years, reflects both the increasing level of savings by clients as well as increasing competition from other MFIs on the micro credit side, particularly from the payroll loan group.

Selected PIs - OIBM	Oct 07 - Dec 07	Jan 08 - Mar 08	April 08 - Jun 08	July 08 - Sep 08
# of Loans Outstanding	17,313	18,578	22,018	27,879
Value of Loans Outstanding (USD)	$ 10,516,980	$ 11,902,501	$ 15,424,406	$ 20,011,627
Total # of Deposits	124,575	122,881	154,360	177,673
Value of Deposits	$ 11,913,308	$ 14,408,431	$ 17,807,759	$ 32,064,388
Portfolio at Risk	2.6%	2.2%	258.3%	1.6%
Return on Assets	1.5%	0.3%	1.3%	3.2%
Loan Portfolio in MK converted to USD at 140.5 MK/USD				

Table 4: OIBM Selected Performance Indicators

PRIDE Malawi

PRIDE began operations in 2000 with start-up funding provided by UNCDF and UNDP. At the end of the project, the Government of Malawi registered PRIDE under the Companies Act as a Corporation Limited by Guarantee assigning a number of prominent citizens with ties to Government as its founders. Under an MOU signed by PRIDE and DMS in September 2005, DMS began providing PRIDE a wide variety of capacity building assistance, including IT equipment upgrades at its head office.

However, mid-way through last year, for reasons not fully disclosed, PRIDE elected to terminate its relationship with DMS and refused to comply with USAID reporting requirements applicable to MFIs receiving US government assistance. Since PRIDE was still in possession of IT equipment purchased by DMS and owned by USAID, its most recent indicators were included in this report since PRIDE continues to benefit from its use.

Performance Indicators PRIDE's inability to legally intermediate savings and its high debt to equity ratio limit its access to sources of loan capital that it needs to boost operating revenues above operationally sustainable levels. It is said to be pursuing plans to transform to a Company Limited by Shares and has sought GoM approval to do so. If successful, this could open the door for new private sector investors to inject much-needed capital for institutional capacity building and additional loan capital.

Selected PIs - PRIDE	Oct 07 - Dec 07	Jan 08 - Mar 08	April 08 - Jun 08	July 08 - Sep 08
# of Loans Outstanding	9,636	10,106	Not Available	Not Available
Value of Loans Outstanding (USD)	$ 1,661,898	$ 1,605,293		
Total # of clients with cash collateral	7,131	7,631		
Value of cash collateral mobilized	$ 355,357	$ 371,427		
Portfolio at Risk	8.2%	12.6%		
Loan Portfolio in MK converted to USD at 140.5 MK/USD				

Table 5: PRIDE Selected Performance Indicators

B. MESO LEVEL

The meso level relates to the overall infrastructure of the financial system which can either aid or obstruct the emergence and performance of MFIs. In the Malawi context this includes Malawi's Microfinance Network (MAMN), technology infrastructure, information systems, capital markets, donors, projects and consulting firms servicing MFIs.

DMS met often in individual and group meetings with MAMN, donors active in Malawi microfinance, projects involved in rural value chains and other stakeholders. The meetings frequently included government representatives operating at the macro level, particularly with regards to proposed changes to the enabling environment for microfinance that have taken place over the past three years.

Malawi Microfinance Network

MAMN has twenty members (up from seventeen in 2007) that either currently provide microfinance services, provided credit in the past or retain an interest in the sector. New members include the Malawi Rural Development Fund (MARDEF), CARE Malawi, and the agribusiness department of Bunda College.

Despite operating since 1998 and being legally registered in 2000, MAMN remains a nascent network with only a full-time program officer and a librarian on staff. Because of this, its Board of Directors and working committees make most if not all management decisions. At its 2008 annual general assembly, a new Board of Directors was elected that is expected to provide guidance and oversee the implementation of MAMN's five-year strategic plan drafted with DMS's help in August 2007.

DMS and MAMN signed an MOU in March 2006 which guides the support provided to MAMN and obligates the network to collect and submit performance indicator data on its members to DMS on a quarterly basis. Key activities funded by DMS last year are described below.

Collection of MAMN Members' Performance Data One of the problems plaguing Malawi's microfinance sector was the lack of aggregate data from sources which could be used by stakeholders to analyze and make decisions. As interest in the sector grew, the pressure on MAMN mounted to provide information on its members' activities to government and others. However, over the past four years the DMS project has been the sole source of supply and demand data on Malawi's microfinance sector and MAMN has had to solicit performance indicator data on its members' activities from DMS. To alleviate this constraint, over the last year DMS worked hand-in-hand to train MAMN's program officer to collect, consolidate and analyze data using collection tools designed by DMS.

FIMA Project Funding Proposal With in-house technical assistance from DMS, a proposal requesting funding from the FIMA project was submitted by MAMN and accepted. Under the terms of the grant, MAMN will receive US $610,000 over a three year period to help finance its operations and implement activities detailed in its Strategic Plan.

MAMN's Relocation and Office Furnishing In October 2007 MAMN moved from its offices at MUSCCO to more spacious surroundings within the Malawi Rural Finance Company (MRFC) headquarters in Lilongwe. Responding to a request for assistance, DMS procured conference furniture consisting of 6 tables and 25 chairs for MAMN's resource centre. The resource center serves both as a library and a conference room and MAMN's improved office space has improved MAMN's profile and enhanced its credibility in the eyes of stakeholders.

Travel to Congo Brazzaville to Participate in AFMIN General Assembly In December 2007 DMS supported MAMN's Board Secretary to attend the Africa Network of Microfinance Institutions' (AFMIN) annual general meeting in Congo Brazzaville. DMS provided air tickets and travel insurance while MAMN covered out of pocket expenses and AFMIN paid for lodging. Upon his return Mr. Kondowe submitted a written report on his trip and gave a verbal debrief to MAMN members.

Rural Agricultural Finance Value Chains (RAF)

DMS recognized in its first project year the importance of integrating approaches to stimulate growth and productivity along agriculture value chains with its own efforts to deepen and expand finance to Malawian MSMEs. USAID/Malawi agreed and, as a result, successfully obtained $600,000 in USAID/EGAT PRIME funds in FY2005 for DMS's work in RAF and to explore the feasibility of setting up a DCA facility for SME ag-related finance. In FY2007, DMS helped to design and put into place a US$13 million DCA loan portfolio guarantee facility with commercial banks that target ag-linked SMEs with loans up to $200,000 over a seven year period.

In Malawi, DMS found that a key reason agricultural value chains fail to realize their potential was due to the high level of information asymmetries that exist between value chain actors, especially with regards to financial services supply and demand. According to studies undertaken by DMS, over 50% of all rural finance is supplied by non-specialized providers such as credit extended by resource input suppliers, agricultural processors, out-grower contracts and others including government and donor projects. Unfortunately, most of the credit supplied outside of formal financial institutions is inefficient, inadequate to meet demand and potentially distorts the market since the cost of credit is usually hidden from the borrower. Without specific information, borrowers think the cost of commercial credit extended by MFIs and banks is exorbitantly high when in fact the hidden cost of credit that they unknowingly pay in their existing relationships is often more expensive.

Thus, the RAF activities undertaken by DMS are intended to overcome information asymmetries between value chain actors so that they are encouraged to explore new ways of relating to each other that are more efficient and which can lead to growth and increased profits. Over the last year this included participation in stakeholder discussions and task forces involved in the articulation of a strategic grain reserve policy and concept note on warehousing receipts, the creation of a public private partnership to develop the cotton sector (CPPP) and other activities involving rural agricultural value chains such as coffee, tea, dairy, cotton, and paprika. Details are described below.

Value Chain Activities In FY2008 DMS built on its efforts and results from prior years by extending the work it had initiated in the coffee, tea and cotton finance value chains and adding to these activities the dairy and paprika sectors. Central to these efforts was networking with other stakeholders and injecting the element of finance into shared efforts and plans to advance the economic development of value chains in Malawi.

Cotton Sector

DMS's work in the cotton value chain was initiated with a credit supply and demand study in FY2007. The study and subsequent debrief meetings to validate and discuss its findings with value chain actors catalyzed the creation of a cotton public private partnership (CPPP) in FY2008. In February DMS hosted a meeting of cotton stakeholders which identified cotton sector regulation as being critical to introduce discipline in the sector and improve product quality. Cotton buying was characterized as having extensive side-selling and as such, securing repayment of loans extended by ginners and others was extremely difficult. The meeting identified two ideas that could help to instill better behaviors in the sector:

- Establishing zones for cotton growing areas;
- Granting licenses to traders and ginners by zones;
- Instituting contract farming for cotton.

Also in FY2008 the CPPP, with funding from Malawi Research into Use Program (MRIUP), conducted a study tour to Tanzania to examine how its sector was organized and to determine what solutions were found to similar problems faced in Malawi. A debrief meeting was held in April at DMS at which it was decided that a Cotton Council umbrella body should be created. The Council would, over time, transform into a regulatory body for the cotton sector.

A second meeting was held in June 2008 with representatives from the Ministry of Agriculture and Food Security, research stations, seed suppliers, input suppliers, ginners, banks, oil pressers and donors. The meeting examined the status of the cotton industry in Malawi, new trends and technologies and the need for farmer organization empowerment to move the industry forward. In the end, the meeting opted for DMS's suggestion to establish a forum on the cotton sector, as was established for microfinance, to be known as a Cotton Development Partnership (CDP). A Steering committee comprising two representatives from each category of players in the cotton value chain was elected. The CDP will have technical working groups for key value chain areas, including one for finance. DMS presence at the meeting helped to ensure proper representation of the financial sector in the CDP and its steering committee.

At the time of this report, commercial banks including Standard Bank and OIBM were developing contacts with ginners and other cotton value chain actors to increase formal finance to the sector. One innovation being pursued by OIBM involves the use of biometric smart cards (Malswitch) to register payments from cotton sales onto an "input reserve wallet" set up on the card. The reserve could later be used to finance the purchase of inputs. OIBM has also begun to send its mobile bank to cotton growing areas in the Salima district in an effort to provide banking services to those previously excluded from the formal banking sector.

Tea Sector

The impact of DMS's work in the tea sector began to be seen over the last year as evidenced by increased competition by banks and MFIs offering financial services to value chain actors. NBS bank, Standard Bank and OIBM all increased the frequency and intensity of their marketing efforts in the tea growing regions. Also, an initiative by CUMO Microfinance Ltd was showing positive results by year end. Using the DMS-sponsored credit demand and supply study on the tea sector, CUMO designed a special loan product for smallholders affiliated with Eastern Produce Estate in Mulanje. In the second quarter CUMO, Eastern Produce, Malawi Savings Bank and the Tea Growers Association signed an agreement that led to new loans to 100 smallholder tea growers in the quarter valued at about MK 1 million (US$7,200). Since then, CUMO has geared up to provide financing to an additional 500 smallholders around Eastern Produce and Lujeri Tea Estates. The loans are enabling smallholders to purchase inputs and new tea plants on previously neglected land as well as to finance non-tea economic activities during the off-season.

Graphic 7: CUMO Client in Restored Tea Acreage

Dairy Sector

Over the year DMS worked closely with Land O' Lakes to facilitate the increase of finance flows to Malawi's dairy sector. In the first quarter, DMS helped Land O' Lakes review 10 proposals for grants that it received by assessing whether the projects would likely be bankable and offering suggestions as to how to improve them prior to presentation to commercial banks for complementary financing. Projects thought to be viable were introduced to Standard Bank's Business Credit Manager for further review.

In September DMS and its commercial bank partners participated in a two-day symposium organized by Dairy Processors Association Limited (DPAL) to raise awareness of all dairy value chain actors to the current state of the dairy sector including its strengths, challenges and opportunities. Among those making presentations was DMS which was asked to expose participants to the financing options available in the dairy sector. The topic generated much interest and led to subsequent one-on-one meetings between small and medium businesses and banks, including Standard Bank and OIBM as well as MFIs such as MRFC and CUMO. As a way forward, participants agreed to appoint a working group to coordinate the preparation of a strategy to guide the development of the dairy sector to increase its productivity and competitiveness.

Paprika Sector

DMS worked closely with the University of Michigan which is carrying out a long-term study funded by the World Bank and USAID/EGAT to investigate the impact of biometrics on loan repayments and savings mobilized by paprika growers associated with Cheetah in Malawi. The study followed 250 paprika farmers of which 123 received in-kind input loans from MRFC. Besides offering expert advice on the structure and implementation of the study, DMS hosted a number of training sessions held over the course of the year. Once the study is completed, DMS will help to disseminate the findings to stakeholders to encourage use of the lessons-learned.

Miscellaneous RAF

In Malawi, DMS works with the Ministry of Agriculture and Food Security to promote value chain financing and investment and is member of the Committee for Agriculture and Agri-Trade development (CAAT). The objectives of CAAT are to help farmers adapt a business approach to their work and add value to their crops through product differentiation and downstream processing to access new markets. The Committee also strives to achieve better coordination between projects and the Ministry of Agriculture and the Ministry of Industry and Trade. As the only project in CAAT that strives to deepen and broaden financial access to agriculturally related businesses, DMS leverages the technical activities and impacts of other projects by introducing a financial service lens to their work. In particular, DMS has worked closely with two EU-funded projects, FIDP (Farm Income Diversification Program) and IDAF (Institutional Development across the Agri-Food Sector). In FY2008 IDAF agreed to sponsor training of business loan clients of Standard Bank to improve their bankability to access loans under the DCA.

Warehousing Receipts
In October 2007 DMS participated in a meeting hosted by the Ministry of Agriculture to discuss a warehousing receipt concept note developed with World Bank funding and executed by a South African consulting company. Comments raised at the meeting included the need for the program to clearly define beneficiaries of the program, costs involved and capacity building requirements at all levels. DMS cautioned that commercial banks and MFIs would need to be brought into the design process at an early stage to ensure that the receipts would be accepted as loan collateral.

In August DMS met with the Grain Traders Association to follow-up on work towards the implementation of a warehouse receipts program in the country that would initially target maize. The Association was still soliciting funding and had little progress to report. However, later in August the Government issued a directive banning the involvement of private traders in the sale of maize, making implementation of warehouse receipts for maize impossible in the near term.

Development Credit Authority (DCA) Loan Portfolio Guarantee

In September 2007 a multi-lender DCA Loan Portfolio Guarantee (LPG) facility targeting ag-linked SMEs was signed by Standard Bank and USAID. Final approval from USAID to put loans under guarantee was issued in mid-December 2007 after Standard Bank paid its commitment fee and satisfied all of the "conditions precedent" described in the DCA Agreement. The total size of the facility is $13 million, $6 million of which is allocated to Standard Bank. The LPG has a tenor of seven years and all loans are in local currency with a 50% pari passu risk sharing. Average loan sizes are expected to be equivalent to about $35,000 with an estimated 520 loans issued over the life of the guarantee. Qualifying borrowers are agriculturally-linked SMEs with permanent employees numbering one hundred or less. The training is expected to take place in FY2009.

For the first two years of the DCA facility DMS is providing technical assistance to banks to help overcome information asymmetries between the banks and their borrowers. DMS is also helping to build the capacity of the banks' SME credit departments to move from "arm chair banking" to one that is customer-centric and market driven. Specific activities undertaken by DMS with respect to the DCA over the past year are described below.

Standard Bank Activities DMS contracted with Bankworld, a US-based firm on Chemonics' AMAP IQC with USAID, to conduct a credit risk management training for Standard Bank in December 2007. The initial session was a two-day train-the-trainer course attended by members of the bank's training department and senior managers from the credit department. This was followed by four-day training on the same topics attended by twenty-six staff that included senior managers, branch managers and account analysts from all Standard Bank branches.

Following the training, Bankworld conducted a training needs assessment which found that the bank's current training program mostly concentrated on operational matters. Specialized training of credit department staff in such topics as account management and risk management was extremely limited and not systematically offered. Standard Bank's training department resolved to take Bankworld's findings and recommendations on board when formulating its next annual training plan. Among the topics recommended to be covered were the following:

1. Advanced financial analysis of loan applications;
2. Development of skills to manage relationships with current loan and deposit customers more effectively and profitably;
3. Selling skills for loan officers to plan, manage and conduct follow-up sales/business calls;
4. Branch management training to help managers supervise and motivate employees with a focus on branch profitability;
5. Implementation of human resource management systems;
6. Asset/Liability management.

Concurrently in December, Kofi Owus-Boakye USAID's DCA Monitoring Officer based in Washington traveled to Malawi to meet for the first time with Standard Bank officials and to conduct a training on the DCA Credit Monitoring System (CMS). Mr. Kofi complimented Standard Bank and DMS for their decision to schedule his and the Bankworld training at the opening of the DCA facility since he believes this to be a key element of success in programs where this was done.

Over a six month period ending 30 September 2008, Standard Bank placed seven loans under the guarantee totaling $228,545 with all loans going to first-time borrowers from Standard Bank. Four of the loans were used to purchase capital assets; the other three were used for working capital. The average loan term was 29 months, although loans used for asset purchase averaged 44 months as would be expected. Interestingly, the numbers of employees at firms receiving loans increased by 86% and two firms increased the number of employees by a combined 155%. Looking forward, Standard Bank indicates it expects to issue more loans under the DCA at an increasing rate as its credit department becomes more adept at working with and financing SME clients.

Business Sector	Start Date	Loan Term (months)	# Employees		Loan Use	Loan Amount	
			before loan	after loan		MWK	USD
Poultry	Apr-08	12	2	4	assets & working capital	300,000	$ 2,113
Saw Mill	May-08	61	35	80	milling machine	13,000,000	$ 91,545
Bakery	May-08	35	30	30	delivery vehicle	6,054,906	$ 42,638
Poultry	Jun-08	23	4	7	working capital	3,000,000	$ 21,126
Dairy Feed	Jun-08	23	6	6	working capital	3,500,000	$ 24,647
Timber Processsor	Jun-08	11	10	35	working capital	3,800,000	$ 26,759
Poultry	Jul-08	35			vehicle	2,800,000	$ 19,717
TOTALS		**Avg = 29**	**87**	**162**		**32,454,906**	**$ 228,545**

Table 6: Standard Bank Loans Placed Under DCA Guarantee

Other DCA Partner Banks Up until the week before the DCA was signed in September 2007, it was expected that NBS Bank would also sign the agreement to take up the remaining LPG balance of US$7 million in the facility. However, in January 2008 DMS received written notification that the NBS Bank Board of Directors had decided not to support NBS Bank's participation in the DCA. With this news, DMS stepped up its efforts to bring other bank(s) onto the facility and met with executive management of all commercial banks in the country. Among these, the greatest interest was expressed by FMB Bank and its sister company the Leasing and Finance Company, as well as OIBM, Ecobank, Nedbank and Indebank.

At mid-year, OIBM formally applied to join the DCA and submitted the necessary information for consideration by the DCA Credit Review Board. A DCA bank analyst working out of the DCA office in Washington evaluated the materials forwarded by DMS and established a risk rating which was within the pre-established acceptable range for the Malawi DCA. The Credit Review Board approved OIBM's application in August and soon after USAID's DCA office and its legal advisor set to work on amending the Agreement to allocate $2 million of the LPG to OIBM. DMS facilitated this work by meeting often with OIBM and USAID, answering questions as they arose and providing technical support to OIBM. The revised DCA Agreement is expected to be signed by OIBM, USAID and Standard Bank in the first quarter FY2009. Discussions with other potential bank partners to take up the remaining uncommitted portion of the DCA are progressing and the remaining unsubscribed portion of the LPG is expected to be assigned in mid-FY2009.

C. MACRO LEVEL

The most appropriate role of government is to aid the development of inclusive financial systems by concentrating on creating an enabling environment at the macro level. Up until two years ago, the GoM occupied a much larger role since it not only set the legal and regulatory framework but had been the largest retailer of microfinance services in the country. However, with the entry of the privately-owned payroll lending group and the large growth in clients at OIBM and MUSCCO, the Government's market share has declined to 17% of loans outstanding from a high of more than 50% in 2004. It is hoped that this trend will continue with the adoption of Malawi's revised Microfinance Policy Statement and the new Microfinance Bill and Financial Cooperative Bill that DMS helped to draft in consultation with major stakeholders. More specifically the Microfinance Policy Statement prescribes that the GoM should avoid involvement in direct retailing of microfinance and instead focus on creating a proper enabling environment.

The activities of DMS at the Macro Level over the past year concentrated on assisting the RBM to complete the drafts of the two microfinance bills and the accompanying regulations and directives and to sensitize microfinance stakeholders as to their content. In addition, DMS participated in a number of sector studies and initiatives to support Malawi's microfinance sector that are described below.

The Reserve Bank of Malawi

For the past two and one-half years a Microfinance Legal and Regulatory Taskforce, chaired by the RBM and including DMS, worked to draft new legislation for the microfinance sector that aims to operationalized Malawi's National Microfinance Policy and its key objective of building an inclusive financial services sector. Recognizing that this requires that microfinance services must be in harmony with international best practices if they are to be sustainable, the new legislation once passed will provide for the regulation and supervision of microfinance services and the licensing and registration of microfinance institutions in Malawi.

DMS provided expert technical support to the Taskforce and engaged the services of the IRIS Center at the University of Maryland, recognized worldwide leaders in microfinance legislation, to contribute to the drafting of the Microfinance Bill, Regulations, and Directives. As for the Financial Cooperatives Bill, DMS worked closely with MUSCCO and the World Council of Credit Unions (WOCCU) who took the lead to draft the Financial Cooperatives Bill and Regulations.

Microfinance Bill and Regulations

Over the course of the year, DMS and the Taskforce made final adjustments to the Microfinance Bill and Financial Cooperatives Bill in order to harmonize it with a new Financial Services Bill that the RBM concurrently drafted. Because of the great change in Malawi's financial landscape over the last twenty years, the RBM felt the need to ensure the presence of an appropriate legal framework for the effective supervision and regulation of the financial services industry. To this end, it drafted a package of new financial sector laws designed to reform and modernize the functioning of the financial sector as well as strengthen and create a stronger foundation for supervision.

The newly drafted Financial Services Bill, of which the Microfinance and Financial Cooperatives Bills are part, is an umbrella law for financial services industry that is interlinked with all other applicable sectoral laws and which will provide a platform for prudent growth and innovation in the financial service industry. It will legitimize the role, duties and functions of the RBM Governor as regulatory authority of the financial services industry in Malawi and ensures that no operator in the financial services industry escape regulation. It will consolidate all supervisory responsibilities and powers under a single Act by removing all regulatory aspects from the underlying sectoral laws and it will create a best practice set of powers for the RBM that will enable it to supervise similar risks in a similar way across sectors.

Final drafting of the Microfinance Bill by DMS and the Taskforce took into account the growing global experience with new products and technologies that are changing the face of microfinance in countries around the world but do not always have a clear legal space in which to operate. This includes such things as branchless banking using new technologies such as GPRS-enabled cell phone networks, money transfer systems to handle remittances, point-of-sale devices, micro insurance and micro leasing, and other financial services that help build an inclusive financial sector. By looking both backward to capture lessons-learned elsewhere, as well as looking forward to anticipate future needs, Malawi's Microfinance Bill is expected to be a best-practice model for others once it is passed.

The Microfinance Bill will apply to those entities providing microfinance services as a whole or a part of their business – but it requires that microfinance must be the primary function or business of any licensed MFI. The Bill attempts to balance the interests of regulation, supervisory capacity, and microfinance innovation by setting up a system of six "tiers." The main assumptions are that, first, microfinance is an activity that can be undertaken by several types of organizations, and second, the regulation to be applied depends on the size of the operation and the extent to which it involves accepting funds from the public. A project or microfinance provider is in the exempt tier unless the total number of clients (depositors and borrowers) is 500 or above, or the loan portfolio is MK 10 million or above. This exemption allows the regulator to focus only on significant operations that might potentially have an impact on the financial sector, and it also allows small providers such as rotating savings and credit clubs (ROSCA) and other informals to continue providing services locally without the risk of criminal liability.

Banks and SACCOs make up another two of the tiers. SACCOs are to be separately regulated, and banks are already covered by the Banking Act. In the latter case, the Bill provides that banks wishing to offer microfinance services must obtain approval for any such new line of services, in accordance with the Banking Act, from the Reserve Bank.

All other providers who pass the exemption threshold must become regulated microfinance institutions. Here there are three tiers: (i) deposit-taking and (ii) non-deposit taking MFIs, both of which must be licensed; and (iii) microcredit providers, which need only register. Deposit-taking MFIs must be share companies, are subject to full prudential regulation and supervision, and may be approved to provide some or the entire array of microfinance services including deposit-taking.

Non-deposit taking MFIs are licensed and subject to regulation based on the range of microfinance services they provide – potentially everything except deposit-taking. This category could include providers of microinsurance, linkage banking, transfers, and other non-deposit services. All entities in this category must either be share companies or create a financial structure that protects the claims of investors and outside creditors.

The "entry level" tier is that of microcredit providers. These include any companies, NGOs, or programs that pass the exemption threshold. They must register and meet minimum capital (or minimum loan fund) requirements, and provide basic financial reports to the Registrar. They are subject to inspection and closure if problems arise, and consumer protection standards apply. In short, they are governed by simple non-prudential regulation.

Financial Cooperatives Bill and Regulations

A separate and distinct bill for Savings and Credit Cooperatives (SACCOs) ensures that they will be able to operate in an environment that recognizes their similarities to banks, microfinance institutions and cooperatives while at the same time allow for their unique differences. The draft Financial Cooperatives Bill establishes a separate and clear regulatory framework for SACCOs in Malawi and once passed, provides for the Financial Cooperatives Act to be the controlling Act if inconsistencies exist. The bill would move prudential regulation of *all* SACCOs from the Ministry of Industry and Trade (MoIT) where the Registrar of Cooperatives resides to the Reserve Bank. At the same time, the MoIT will retain the responsibility for the registration, governance and promotional aspects of SACCOs. The Bill would allow for both primary and secondary SACCOs to exist and it would create a prudential and policy framework for SACCOs to operate while limiting the administrative burdens for the SACCOs and the Reserve Bank.

Some key aspects contained in the draft Financial Cooperatives Bill are presented below.

Licensing For a new primary SACCO to start operations, it must first register as a limited liability cooperative with the MoIT. Once registered, primary and secondary SACCOs must obtain, within 2 years of being registered, a license from the Reserve Bank to provide approved financial services. As part of the licensing process a SACCO must demonstrate a viable business plan, member interest and provide other details of its directors and manager. SACCOs cannot provide financial services without a license from the Reserve Bank and the Reserve Bank may suspend or revoke a license for a variety of reasons and can remove directors/employees.

Governance The Bill describes governance requirements including fit and proper standards for directors and criteria for removing directors – such as having loans past due sixty days, being convicted of a felony, filing for bankruptcy, etc. The Bill establishes a minimum board size of seven and limits directors to two consecutive terms or not more than three years each. After sitting out at least a full term, past directors can be re-elected. Any payment, reimbursement or compensation provided to directors, with the exception of the Chief Executive Officer who can serve as a non-elected director, must be disclosed annually to members at the annual general assembly.

Operational and Regulatory Issues Like the draft Microfinance Bill, the draft Financial Cooperatives Bill envisions a five-year transition and implementation period. Additional issues that are addressed in the Bill are:

- *Prudential Standards of SACCOs:* The Reserve Bank will prescribe standards for liquidity ratios, loan loss provisions and an acceptable range or return on assets;
- *Membership:* SACCOs would be able to provide services to individuals and body corporates. SACCOs could provide fee-based services to non-members but they cannot make any loans, lines of credit or accept deposits from non-members. Individuals or body corporates could be members in more than one SACCO;
- *Insider Lending:* Provisions for declaring potential conflicts of interests are required;
- *Investment of Funds:* Non-financial investments are limited to 5% of total assets; the types of permitted investments are described;
- *Level playing field:* As a result of coming under prudential supervision, it is envisioned that SACCOs will also enjoy the benefits of such oversight including direct access to the Reserve Bank's liquidity window, access to deposit insurance (if it becomes available) and direct access to the payment system for secondary SACCOs.

World Bank Financial Sector Appraisal Program

At the request of the GoM, in 2008 the International Monetary Fund and the World Bank conducted a Financial Sector Assessment (FSAP) for Malawi to determine the extent to which the public was able to access financial services. As the principal source of microfinance information given DMS's involvement in all aspects of the sector, the FSAP team held several consultative meetings with DMS during its multiple missions to Malawi. Although the final FSAP report has a restricted distribution, the FSAP team presented its findings at a meeting of key stakeholders hosted by the RBM.

Key conclusions pertaining to the microfinance sector mirrored the opinions of DMS and included the following:

- Up to 90% of Malawi's adult population is unbanked;
- Household level supply and demand for financial information is lacking;
- Tremendous opportunities exist for technology-based solutions to increase access to financial services;
- Government of Malawi should focus its interventions at the sector's macro level, reduce its direct provision of financial services and support the private sector to take the lead in the retail delivery of financial services.

FIMA Project

FIMA (Financial Inclusion in Malawi) is a project initially funded by UNDP and UNCDF and later by Cordaid, with goals much the same as those of DMS to build an inclusive financial sector in Malawi by providing assistance at all three levels of the sector. The project was approved by the GoM in 2007 and its management unit is housed in the Ministry of Finance which maintains an active involvement in the project's management. The project design allows new donors wishing to support the development of Malawi's microfinance sector to join the project by committing money to the FIMA Fund, which was set up to provide grants and loans used to build MFI capacity and expand credit provision.

The minimum level of donor investment to sit on the FIMA Fund Investment Committee is $1million. Through USAID's investment in Malawi's microfinance sector through the DMS project, it is seen by FIMA as having met this minimum threshold and was thus accorded a seat on both the FIMA Steering Committee (SC) and its Investment Committee (IC). USAID and DMS have jointly attended FIMA meetings and when it could not be present, USAID delegated its seat to DMS. In this capacity, DMS has been a key partner to the FIMA project from its design phase through its start-up and implementation stages. Besides the funding it provides through the FIMA fund, FIMA has finalized grant agreements with the RBM and MAMN which complement DMS's work with both entities. In summary, DMS and FIMA have benefited greatly from the synergies between the two projects and the close working relationships between them has greatly leveraged each other's resources for greater project impact than would otherwise have been possible.

Microfinance Forum

The Microfinance Forum is a microfinance stakeholder group with representation from all entities having an interest in Malawi's microfinance sector. Members of the MF Forum's Technical Working Group, tasked with overseeing the development of a National Strategy for Financial Inclusion in Malawi, made a study tour in May to Madagascar in order to examine its experiences having faced the same challenge. DMS's Chief of Party accompanied the team to Madagascar to help record lessons-learned that could be incorporated and supported in Malawi. Both FIMA and DMS will provide assistance to the MF Forum and the Technical Working Group over the coming year.

IV. FINANCE

In September 2007 DMS received a 2-year funded project extension that increased the Task Order by $1,052,482 and raised the project's ceiling price to $4,529,538. At the same time, the contract ending date was pushed to September 30, 2009 and $1,285,000 in new obligated funding was received.

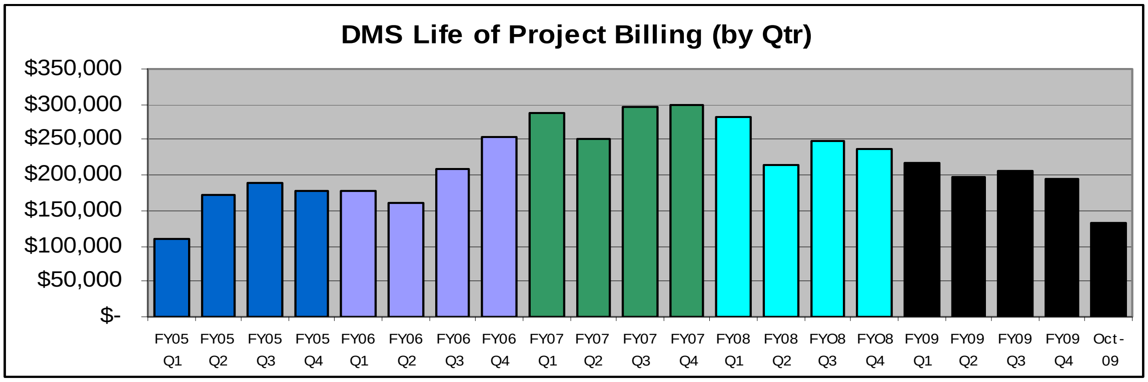
Project expenses are tracked against the three cost categories in the DMS Task Order: Labor, Materials, and G&A. The FY2008 quarter-by-quarter project expenditures are detailed in Table 7 below. The final obligation that brought the project funding up to the contract ceiling was received in September 2008. This leaves a balance of $963,383 in funds for the final project year to cover remaining technical activities as well as all close-out expenses.

Line Item	FY2008				Yrly totals	LOP totals
	Q1	Q2	Q3	Q4		
Labor	168,761.43	140,402.71	149,625.91	138,242.67	597,032.72	2,033,636.79
Materials	106,651.13	70,659.91	92,615.40	93,211.26	363,137.70	1,446,594.30
G&A	6,345.71	4,204.27	5,508.47	5,546.07	21,604.52	85,923.90
Subtotals	281,758.27	215,266.89	247,749.78	237,000.00	981,774.94	3,566,154.99
Remaining Obligation	958,861.68	743,594.79	495,845.01	963,383.01		
Remaining Funding	1,663,399.68	1,448,132.79	1,200,383.01	963,383.01		
** Note: Final obligation of $704,538 received Sept 2008 to reach 100% of the $4,529,538 contract ceiling*						

Table 7: DMS Quarterly Expenditures

It is important to note not just the total amount expended, but also the trend in total monthly expenditures over the life of the project (LOP). As described in previous reports, the project started slowly to match the flows of obligated funding received. As funding increased in year two, the Commercial Finance and Enabling Environment Specialist position was filled. Besides increasing project expenses, his addition directly contributed to the project's success in RAF value chains, the DCA design and approval and the drafting of new microfinance legislation. At the same time, the increase in funding flows enabled the Capacity Building Specialist (CBS) to expand technical assistance to MFIs that helped to close the gap of operationally sustainability in those structures. The effect of increased funding on the level of technical activity expenses in years two and three is easily seen in Graphic 8 below. However, in year four the project had to reduce its burn rate to fit within its contract ceiling by using fewer short term consultants and firms and providing direct assistance through its own technical staff.

In terms of monthly expenditures, year one averaged $53,941/mo, year two $66,965/mo, year three $94,467/mo and last year $81,814. However, in FY2009 DMS must decrease its FY2008 burn rate to an average of $68,036/mo in order to adequately fund closeout expenses estimated at $131,391 that will be billed in October 2009. This translates to a reduction in the usage of short term consultants and subcontractors to assist with the provision of technical assistance and a greater reliance on in-house assistance provided by DMS technical staff.



Graphic 8: DMS Quarterly Billing

V. MONITORING AND EVALUATION

The information below is an analysis of the Performance Indicators (PIs) that are a part of the project's Project Management Plan (PMP). The indicator data are found in the annexes to this report.

A. MICRO : DMS-SUPPORTED FINANCIAL INSTITUTIONS

The indicators discussed in this section are **A1 through A6** and refer to the combined indicator reports from FINCA, PRIDE, MUSCCO and OIBM who received direct capacity building assistance under the DMS project. (See Annex 1)

At the micro level, the performance indicators (PIs) track the evolution of the financial strength and outreach of DMS client institutions using individual institution reports and combined data that measure the overall outreach in the sector. It should be noted that in Malawi the peak time for micro loan portfolio size is the end of December when the outstanding agricultural loans are at the maximum. This contrasts with the monitoring and evaluation data reported in the annexes which are collected at the project's fiscal year end of September, a time when microloans are at their lowest since farmers generally purchase agricultural inputs in October. However, since the targets are expressed as year-to-year improvement, the baseline and actual can be compared since they are captured at the same time of the year.

As previously noted, PRIDE Malawi did not submit its performance indicators as required for the last two quarters of FY2008. According to USAID policy, it has thus become ineligible to receive further assistance from the US Government and DMS has stopped providing support. However, since PRIDE continued to use the IT equipment owned by USAID and installed at its headquarters, PRIDE's indicators reported as of March 31, 2008 have been included in this report. The other directly-assisted MFIs (FINCA, OIBM and MUSCCO) met all reporting requirements throughout the year.

The cumulative value of loans disbursed by MFI partners increased by 42% and cumulative numbers of loans disbursed improved by 43%. The large increases were mainly due to OIBM which was 188% over its prior year in value of loans and 177% in cumulative numbers of loans disbursed. MUSCCO also contributed with increases of 3% in cumulative loan value and 39% in cumulative number of loans.

Key ratios such as portfolio at risk (PAR) improved, moving from 5.1% overall to 3%. OIBM and MUSCCO showed the largest gains while FINCA remained largely unchanged. PRIDE on the other hand slipped from 9.1% to a worrying 12.6% as of March 2008. For FINCA, OIBM and MUSCCO, return on assets improved moving from a negative 0.6% to a positive 0.3%, which translates to an overall improvement of 148%.

Overall, OIBM continued to show strong results thanks to continued growth fueled by its branches in Kasungu and Limbe that opened in 2007. Also the addition of secure mobile banking vehicles continued to extend OIBM's geographical outreach to rural areas not served by conventional banking halls. In what is proving to be a winning strategy, OIBM has used the mobile banks to build a clientele in rural areas by slowly increasing the frequency of visits to the area as the numbers of clients grow. Eventually, when a minimum threshold is reached, it can build a permanent branch office that is already at a break-even size even before it opens. A picture of OIBM's mobile branch vehicle can be seen on the cover of this report.

In terms of market share, OIBM's now supplies 31.6% of the micro loans outstanding in the sector and 52.2% of micro savings. MUSCCO provides 12.7% and 17.6% respectively and FINCA's market share is 3.5% and 1.3%. However, since only OIBM and MUSCCO can legally intermediate savings at this time, FINCA's limited ability to increase its loan fund is a constraint on its growth. This could change should it transform into a share company, thus attracting private capital, and if it obtains a deposit-taking license once the new Microfinance Bill passes.

To its credit, FINCA continues to work through its restructuring period and shows positive trends having successfully diversified its loan products and concentrated its efforts to invest in profitable branches and close those having a small chance of achieving operational sustainability. Formerly high staff turnover at FINCA has stabilized and staff capacities have increased measurably. FINCA's improvements to PAR in 2007 were maintained in 2008 and its ROA showed a 36% improvement over 2008.

With the exception of OIBM which has been able to secure capacity building assistance from a number of sources, FINCA and MUSCCO count on DMS to help them continue the gains shown over the past four years and to help them comply with the impending new microfinance legislation expected to be passed in the near future.

B. MICRO LEVEL – SECTOR WIDE

The sector wide indicators track the total microloans (value and number) and microsavings (value and number) issued by formal, specialized financial institutions.

Outstanding loan value and total number of loans outstanding (A7 & A8): The total loan value outstanding in the sector increased by 109% and the number of micro loans increased by 79% over the previous year. This dramatic increase was due to the market entry of the payroll lending group that now has a combined portfolio outstanding of MK 2,760,257,558 (US$19.5m) representing 31.4% of the market. This remarkable achievement has been realized less than 18 months after the first payroll lender opened its operations in Malawi.

Number of depositors and total value mobilized in sector (A9 & A10): The value of deposits in the sector increased by 61% to MK 8.3 billion and the numbers of depositors increased by 17% to 733,086. This increase in value was largely due to the performances of OIBM (160% increase) and MUSCCO (38%) who together accounted for overall market shares of 32%, and 13% respectively.

In a reversal from DMS years two and three, the value of micro loans outstanding and the number of clients with micro loans exceeded the value and number of micro savers in the sector. As explained earlier, this was due to the entry of the payroll loan group. If not, the previous pattern indicating a strong demand for micro saving services would have repeated. Since the typical micro credit provider operating in rural areas does not have the legal right to intermediate savings, it is constrained from expanding its loan portfolios due to lack of capital. However once passed, the Microfinance Bill will open up legal space for deposit-taking MFIs which in turn should lead to a deepening and broadening of Malawi's microfinance sector.

C. MESO LEVEL

Meso level indicators measure the change in the support environment for MFIs in Malawi. In particular, targets for year two focused on increasing networking activities between institutions, projects, and donors within the sector as a whole, including regulators.

The first indicator, **B1** refers to the number of project-supported MFIs who undergo a credit rating during the year. In FY2009, MUSCCO underwent a Smartrac risk rating as described earlier. FINCA elected to postpone its ratings until a future time since it was heavily engaged in capacity building activities that it wanted to take hold before subjecting itself to an outside rating.

The second indicator, **B2** measures the number of MF stakeholder meetings held. The target number of meetings was ten, and there were a total of eleven meetings held. A number of these were meetings of the Microfinance Legal and Regulatory Task Force and related stakeholder meetings to discuss the new Microfinance legislation.

Two new indicators, **B3 and B4**, were established to track the DCA facility up-take by qualified SMEs. The first refers to the number of agriculture-related firms benefiting directly from USG interventions and the second the value of loans issued by DCA bank partners that were placed under the DCA guarantee. A total of 7 firms were issued DCA guaranteed loans that were valued at $228,545. While both indicators were under-target, it is expected that appropriate steps have been taken to improve on their performance next year. These include bringing other banks onto the DCA agreement and improved capacity and comfort level at the partner banks to issue more SME loans.

D. MACRO LEVEL

Macro level indicators attempt to measure awareness and dialogue around policy and regulatory issues. It was agreed that appropriate performance indicators for this category would be submitted to USAID for approval after the MF and Financial Cooperative Bills are passed into law. Since these Bills have not yet been sent to Parliament, performance indicators were not set. Nonetheless, DMS was very active at the macro level last year as described in Section C. Among other things, the final drafts of the Microfinance Bills were submitted to the Justice Department to ensure the text was in the required format of Malawi legislation. Also, meetings with stakeholders on the content of the Bills and surveys of microfinance practitioners to assess their readiness to comply with the future legislation were carried out.

ANNEX 1: MICRO-LEVEL DMS PERFORMANCE INDICATORS

A. Micro Level - DMS Assisted MFIs: FINCA, MUSCCO, OIBM, PRIDE									FY 2008 ANNUAL REPORT
Performance Indicators (DMS Clients)		Baseline Source	Sub-category	Baseline Value	Target	Period : Oct 2007 - Sep 2008 Actual # or MK	Value USD	% Incr. over prior year	Comments
A1	Total value (cumulative) of loans disbursed	Previous report	Total (male + female	5,058,572,533	20% above prior year	**7,190,512,385**	$50,996,542	**42%**	The increase was largely due to OIBM who was 188% over last year. MUSCCO increased by 3% whereas FINCA increased by 5%. In the case of FINCA, the reasons for he modest increase are related to the lack of availabitliy of additional loan capital for onlending and a "purging" of clients with loans chronically in arrears. PRIDE had a small decline over the previous year.
			Male	2,909,829,492		3,693,896,222	$26,197,846	27%	
			Female	2,157,742,942		3,496,616,163	$24,798,696	62%	
			% ag-related loans			7.55%			
A2	Cumulative # loans disbursed	Previous report	Male	208,527	20% above prior year	**298,694**		**43%**	The target was surpassed thanks to OIBM that was 177% of last year, MUSCCO 39% ahead. FINCA declined by 1%.
			Female	142,792		**170,432**		**19%**	
A3	Number of depositors	Previous report	Total	189,301	20% above prior year	**281,641**		**49%**	At year's end, a net 53,816 new depositors became clients of the 4 assisted MFIs with all 4 registering impressive increases: OIBM 93% increase and MUSCCO 28%. FINCA declined by 19% as it closed some unprofitable branches and applied cash collateral against overdue loans.
			Male	85,360		181,261		112%	
			Female	103,940		100,380		-3%	
			Savings	117,305		209,464		79%	
			Guarantees	23,055		86,546		275%	
A4	Total value of deposits mobilized	Previous report	Total	2,985,739,965	20% above prior year	**6,147,088,370**		**106%**	The increase in deposits mobilized which exceeded the increase in numbers of depostors was largely due to the performance of OIBM who increased by 160% though MUSCCO increased by a healthy 38%.
			Male	1,482,324,498		3,940,112,823	$27,944,063	166%	
			Female	1,503,415,466		2,206,975,547	$15,652,309	47%	
			Savings	1,917,933,442		4,580,137,909	$32,483,248	139%	
			Guarantees	1,070,060,599		1,514,764,972			
A5	Portfolio at Risk (PAR) ratio	Baseline at time MOU is signed	-	5.1%	10% improvement	3%		**45%**	Overall PAR improved significantly from its high of 5.1% last year to 3% overall in FY2008. However results varied from MFI to MFI: OIBM improved from 2.7% to 1.6%; MUSCCO from 4% to 3%; FINCA unchanged from 4.8% to 5% and PRIDE 9.1% to 12.6% (as at March 31, 2008).
A6	Return on Assets (ROA)	Baseline at first time LLR is calculated after MOU	-	-0.6%	10% improvement	0.30%		**148%**	Total return on assets improved markedly led once again by OIBM 1.7% to 3.2%; MUSCCO was unchanged at 5%; FINCA improving from -11% to -7%. PRIDE information was not available.

** PRIDE refused to share its Pis for the 3rd and 4th quarters as it decided in August to "opt out" of receiving DMS assistance although it remains in posession of IT equipment still owned by USAID. Therefore the indicators reported here are those submitted for the period ending March 2008 and others submitted to MAMN in Sept 2008.*

ANNEX 1: MICRO-LEVEL DMS PERFORMANCE INDICATORS (CONTD.)

A. Micro Level: Promoting Strong Retail-level Institutions		FY2008 ANNUAL REPORT								
Performance Indicators (DMS Clients)		Definition	Frequency	Baseline Source	Baseline Value	Period: Oct.07 - Sep.08				Comments
						Target	Actual MK	Value US $	Achieved	
A7	Total value of loans outstanding in MF sector	Total value of micro credit loans at ALL MFIs reported in MK and also in US$ converted at exchange rate on September 30th	Annually	Prior Year Report	4,218,227,307	10% above previous year	8,798,333,714	$62,399,530	109%	The target was vastly exceeded due to the entry of the payoll lending group which accounted for MK 2.7 billion. Although without them, the increase would have been 43% over the prior year.
A8	Total number of loans outstanding in MF sector	Total number of micro credit loans outstanding at all institutions operating in the MF sector	Annually	Prior Year Report	253,874	10% above previous year	455,179	-	79%	Without the payroll lenders, the increase would have been 33% over the prior year.
A9	Number of depositors reported in MF sector	Total number of micro finance depositors that have accumulated deposits as savings or as loan guarantees at all institutions operating in the MF sector	Annually	Prior Year Report	626,560	10% above previous year	733,086	-	17%	The only two private sector MFIs able to intermediate savings, OIBM and MUSCCO increased 95% and 28% respectively.
A10	Total value of deposits mobilized in MF sector	Total value of deposits mobilized as savings or as loan guarantees, in the case of MFIs legally prohibited from mobilizing savings, at all institutions operating in the MF sector reported in MK and also in US$ converted at exchange rate on September 30th	Annually	Prior Year Report	5,136,677,275	10% above previous year	8,291,316,215	$58,803,661	61%	Large increases in savings mobilized at MUSCCO (38%) and OIBM (150%) were partially offset by no change in deposits at MSB whose market share declined from 33.7% to 21.4%

* *Exchange rate applied is 141 MWK / US$*

ANNEX 2: MESO-LEVEL DMS PERFORMANCE INDICATORS

B. Meso Level - Supporting Industry Infrastructure FY2008 ANNUAL REPORT						
Performance Indicators (DMS Clients)		Definition	Frequency	Oct.07 - Sep.08		Comments
				Target	Achieved	
B1	Number of project-supported MFIs who pay part or all of the costs of a credit rating (each year)	USAID-financed MFIs will allow themselves to be rated using a MFI rating instrument such as MicroRate, Planet Rating or others.	Annual	2	1	MUSCCO was partially rated under the SMARTRAC Risk Rating Exercise. PRIDE was rated in 2007 and FINCA postponed its rating to 2009.
B2	Number of MF stakeholders meetings held	MF Stakeholder meetings include broad representation from MFIs, parastatals, MAMN, reserve bank, Govt. of Malawi ministries, bilateral and multilateral donors, MF sector support structures, project staff.	Annual	10	11	Includes meetings on MF legal & regulatory framework, Ministry of Industry and Trade MF Forum meetings, rural agricultural value chain workshops, sectoral study debriefs,
B2	Number of agriculture-related firms benefiting directly from USG interventions	Number of qualified borrowers receiving financing from a DCA bank partner whose loan is guaranteed under the facility	Annual	10	7	See below.
B3	Amount of private financing mobilized with a DCA guarantee	Value of loans in US$ issued by DCA bank partners and placed under the DCA guarantee	Annual	$2,000,000	$228,545	The target was missed because of the following reasons: the DCA facility was operationl later than expected, NBS bank dropped out of the DCA at the last minute Standard Bank did not meet its own 1st year targets.

ANNEX 3: MACRO-LEVEL DMS PERFORMANCE INDICATORS

C. Macro Level - Fostering a Conducive Policy Environment and Appropriate Role of Government							FY2008 ANNUAL REPORT
Performance Indicators (DMS Clients)		Definition	Frequency	Baseline Value	Period: Oct.06 - Sep.07		Comments
					Target	achieved	
C1	*Appropriate Performance Indicators to be determined and submitted to USAID for approval after the pending Microfinance Bill and Financial Bill are passed into law by Cabinet and Parliament*		Annual	zero	n/a	n/a	Because of political reasons, most bills expected to be presented to Parliament in 2008 were delayed and are not expected to go before Parliament until mid-2009. Nonethless, significant effort was expended by the project during FY2008 to finalize the drafts of the Microfinance and Financial Cooperatives Bills through the MF Taskforce and DMS's subcontracts with the IRIS Center, surveys of MFIs by DMS and facilitation of sensitization meetings with MF stakeholders to validate Bills and seek consensus on their content.