



USAID
DEL PUEBLO DE LOS ESTADOS
UNIDOS DE AMÉRICA

MEXICO

AFIRMA QUARTERLY REPORT

YEAR I QUARTER 3 (April-June 2005)

July 31, 2005

The AFIRMA Project, managed by Development Alternatives, Inc. prepared this publication for review by the United States Agency for International Development.

AFIRMA QUARTERLY REPORT

YEAR I QUARTER 3 (April-June 2005)



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

CONTENTS

- 1. Executive Summary 1
- 2. Introduction 1
- 3. AFIRMA Workplan Implementation 1
 - 3.1 Strengthen MFI institutional capacity 1
 - Task One Indicators 7
 - 3.2 Develop a Local, Commercially-based MFI Support Services Industry 12
 - 3.3 Develop innovative products & technologies to expand access to rural financial services & remittances 13
 - 3.4 Strengthen the policy environment for micro- and rural finance 14
 - 3.5 Strengthen the micro- and rural finance industry 14
- 4. Project Management 16
 - 4.1 AFIRMA Budget vs. Actual Expenses 16
 - 4.2 Projected AFIRMA Investments – Next 6 Months 17
- 5. AFIRMA Priorities for Next Quarter 19

- Table 1 – AFIRMA Partner MFIs 2
- Table 2 – Task One Indicators 7
- Table 3 – Task Two Indicators 13
- Table 4 – Task Three Indicators 13
- Table 5 – Task Four Indicators 14
- Table 6 – Task Five Indicators 15
- Table 7 – Comparison of Current Budget to Actual Expenses 17

I. EXECUTIVE SUMMARY

The Access to Rural Finance for the Microenterprise (AFIRMA) Project, a USAID/México-funded project implemented by Development Alternatives, Inc. (DAI), forms a central part of USAID/México's Strategic Objective (SO): **Increased Access to Financial Services by Underserved Populations**. AFIRMA is designed to help build an inclusive, sustainable microfinance sector in Mexico as a means to increase access to a range of financial services and contribute to economic development. This report describes project activities over the period April-June 2005, quarter 3 of project year 1. Below is a summary of the quarter's activities under each of AFIRMA's main tasks:

- **Task 1: Strengthen the institutional capacity of MFIs.** During the quarter AFIRMA focused heavily on this task, establishing strong working relationships with the 12 partner MFIs previously selected as AFIRMA partners. The AFIRMA team, supported by a group of national and international consultants, delivered tailored technical assistance to address each institution's priority areas. Technical assistance included strengthening internal controls, planning and implementing management information systems, adjusting savings and credit products and methodologies, beginning to develop new products, and strategic and operational planning. AFIRMA takes a holistic approach to assistance, and having gained confidence of partners through initial activities, in quarter 4, AFIRMA will assist partners with strategic and business planning prior to focusing on additional of specific need. This will involve defining areas where AFIRMA can most effectively help partners reach their goals.
- **Task 2: Develop a local, commercially-based MFI support services industry.** AFIRMA designed a survey and approach to addressing this task that will be further defined in quarter 4, when USAID intern Virginia Brandon will work with Training specialist Claudette Martinez and Senior Microfinance Specialist from Acción, Ricardo Calvo to analyze the market for support services and to design a program to meet areas of greatest need.
- **Task 3: Develop innovative products and technologies that expand access to rural financial services and remittances.** This area will be further defined in quarter four through an internal project retreat with the entire AFIRMA team, and partners at USAID including new AFIRMA CTO Geoffrey Chalmers.
- **Task 4: Strengthen the capacity of the CNBV and federation committees to supervise RFI and MFIs.** AFIRMA has planned meetings with CNBV for quarter 4 in order to define work in this area. The project is also planning to co-sponsor a conference bringing private sector players together with representatives from the CNBV and Federation Committees (delegated authorities) and international experts such as Ramon Rosales and his colleagues of AFIRMA subcontractor International Consulting Consortium, to discuss the state of the art in regulation and supervision of microfinance, and its potential applications in Mexico.
- **Task 5: Improve the enabling environment for the rural and microfinance industry.** In quarter 3, AFIRMA continued to support ProDesarrollo. Efforts this quarter focused on co-sponsoring (with the Ford Foundation) internal and external audit training for MFIs and their external auditors. AFIRMA also planned additional activities with ProDesarrollo in the area of costing analysis (to be held in August) and a leadership training (November).

Key developments from a project management standpoint included:

- Willy Escobedo joined the long term project team as Senior Microfinance Specialist during quarter 3, following a successful career with Caja Municipal de Ahorro y Credito de Arequipa (Peru), and after productive short-term consulting assignments with DAI in Ecuador and under AFIRMA.
- The mission requested an adjusted budget in order to add the position of Deputy Chief of Party, deemed necessary in order to manage the intense level of technical assistance contemplated as a result of the inclusion of 12 partner MFIs (as opposed to the originally-envisioned 6-7). On July 15 (quarter 4) USAID formalized the first contract modification, approving the modified budget and addition of Nathanael Bourns from DAI to fill the position of DCOP. Mr. Bourns will join AFIRMA full-time in August.

2. INTRODUCTION

The Access to Rural Finance for the Microenterprise (AFIRMA) Project, a USAID/México-funded project implemented by Development Alternatives, Inc. (DAI), forms a central part of USAID/México's Strategic Objective (SO): **Increased Access to Financial Services by Underserved Populations**. AFIRMA is designed to help build an inclusive, sustainable microfinance sector in Mexico as a means to increase access to a range of financial services and the. The project's main goal can be summarized as:

"To contribute to the development of a dynamic, effective microfinance sector in Mexico that provides sustainable financial services to under-served urban and rural market segments."

The AFIRMA Contract Scope of Work (SOW) and Year One Workplan outline five distinct, interrelated tasks:

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

Progress towards each of these tasks over the three-month period from April 1, 2005 through June 30, 2005, (quarter 3 of project year 1) is presented in the next section. Following that is a description of project management over the quarter, including a summary of project finances. The final section highlights AFIRMA priorities for the next quarter (July-September, 2005).

3. AFIRMA WORKPLAN IMPLEMENTATION

Consistent with the Year 1 Workplan project activity was most intense this quarter under Task 1 – Strengthen the institutional capacity of MFIs, although the project team also undertook significant activities under tasks 2 and 5.

3.1 STRENGTHEN MFI INSTITUTIONAL CAPACITY

One of the primary goals for project year one is to identify AFIRMA Partner Microfinance Institutions (MFIs)¹ and develop assistance plans for key areas, with the ultimate goal of increasing and improving their delivery of financial services to greater numbers of clients. During the quarter, having previously selected 12 MFI partners and identified priority areas for assistance, AFIRMA identified and mobilized consultants to work with each institution. Below is a summary of AFIRMA support for each partner in quarter 3. Following the description of activities, indicators as of June 2005 are presented.

¹ MFIs broadly understood here to mean financial institutions serving microenterprises, rural or other underserved populations.

Table I – AFIRMA Partner MFIs

Institution	Legal Structure	Regulated	Active Borrowers 12/2004	Current Areas of Focus
1. FIMEDER	S.A. de C.V.	No	1,090	Individual and Solidarity Group lending in semi-urban areas of the State of Mexico and in DF
2. AISol	Asociación Civil	No	3,606	Grameen Bank methodology in rural areas of Chiapas
3. DESPENO	S.A. de C.V.	No	5,444	Solidarity group lending and agricultural lending (primarily through FIRA) in Sinaloa,
4. CADEMI	Asociación Civil	No	6,048	Urban & semi-urban village bank lending in San Luis Potosí, Matehuala, Zacatecas
5. AMUCSS	Asociación Civil	No	6,393	Individual & Solidarity Group lending. Network of 7 <i>Microbancos</i> in Semi-urban and rural areas of Oaxaca, Puebla, Hidalgo, Guerrero, Morelos & Michoacán
6. Fondo 5 de Mayo	Asociación Civil	No	7,587	Solidarity Group lending in southern part of the State of Puebla
7. Pro Mujer	Asociación Civil	No	11,933	Village bank lending in semi-urban areas of the States of Hidalgo and Queretaro
8. FINCA	Asociación Civil	No	22,374	Village bank lending in semi-urban areas of the States of Morelos, Guerrero, & Puebla
9. FinComún	Unión de Crédito	Yes	26,832	Savings, solidarity group/individual lending in region of Mexico City
10. CAME	Institución de Asistencia Privada	No	59,036	Village bank and individual lending in urban and semi-urban areas of the State of Mexico and the DF.
11. Caja Libertad	Cooperativa de Ahorro y Préstamo	No	235,068	Traditional credit union savings and loan products. National Coverage in urban and semi-urban areas. Total members of the credit union shown here.
12. Compartamos	SOFOL	Yes	309,637	Village bank and individual lending with national coverage, although concentrated South of DF.

I. FIMEDER

Trip to Ecuador – AFIRMA Chief of Party Fernando Fernandez accompanied FIMEDER General Manager Norma Rodriguez, Commercial Director Marco Estrada, and Branch Manager Yanet Velasco to visit Banco Solidario, Banco Procredit, Banco Guayaquil, a national credit bureau, and the Ecuadorian Superintendency of Banks. The study tour placed particular emphasis on long term institutional strategies for serving the microenterprise market, governance, business models for microfinance, and analyzing results.

AFIRMA also defined a technical scope of work to support FIMEDER with its human resources functions, with emphasis on processes related to loan officers. Specifically, the project will help define FIMEDER's process for defining loan officer profiles, identifying and hiring candidates, ongoing incentive schemes and training programs.

2. AISol

AFIRMA worked with AISol General Manager Katia Corroy to define the first area for assistance: adjustments to products and the lending methodology. AFIRMA identified and mobilized Vivianne Romero, a consultant with substantial group lending experience from time spent working for and advising Crecer, one of Bolivia's successful village banking institutions that has substantial operations in rural areas.

Ms. Romero highlighted important areas for improvement in the lending methodology, which AISol will be addressing in coordination with AFIRMA. She also highlighted the need to undertake strategic and business planning, and recommended that the project assist with planning. Furthermore, it is clear that AISol needs ongoing assistance from a microfinance operations specialist with substantial experience managing microfinance operations to help over an extended period, and to train the individual who will take up the position of operational manager, which is currently vacant. AFIRMA will discuss with AISol management and the board of directors how best to address this need and where the project can help.

3. DESPENO

During the diagnostic phase, AFIRMA indicated that Despeno's credit methodology required significant adjustments prior to being able to grow the credit portfolio substantially. AFIRMA brought in Claudia Ordóñez, who has worked with DAI intermittently over the last 5 years as an operational expert in microcredit methodologies, to identify and begin to address holes in the current methodology. Ms. Ordóñez's support was very well received. Despeno showed complete openness to her recommendations and will continue working with her to implement changes in the methodology.

Another area in need of support is human resources. Ms. Ordóñez pointed out that Despeno requires a human resources strategy in line with the institution's growing emphasis on microcredit. Next quarter, AFIRMA will bring in Eliana Otondo, a human resources expert who has experience in microfinance in Mexico, Bolivia and India, to refine Despeno's approach to human resources (which currently involves outsourcing most positions, including loan officers, to independent contractors).

Despeno also requested help to carry out a market study focused on understanding supply and demand for microcredit in Sinaloa and Baja California, their main markets. AFIRMA will discuss options with Despeno in quarter 4, depending on the study's consistency with Despeno's strategic plans.

4. CADEMI

Although it was established relatively recently, CADEMI's has had significant financial success, has grown relatively, and has very aggressive future growth plans. Ramiro Carrasco of Quisqueya Finance, who participated in the AFIRMA diagnostic phase, was brought in to review CADEMI's institutional infrastructure and lending methodology in order to support the institution's aggressive growth strategy. Mr. Carrasco's main findings were that CADEMI need to adjust their institutional framework and credit product and process in order to better adapt to the market, and to tailor products and processes more to client needs. These elements become increasingly important as competition increases, as it has in San Luis Obispo.

One area that AFIRMA will monitor is that CADEMI is considering offering consumer loans to new market segments. AFIRMA will work with the General Manager and the Board of Directors to examine the pros and cons of moving into this market, and how it might affect other lending.

5. AMUCSS

AMUCSS lacks accounting information that would allow for analysis of overall performance and AFIRMA is supporting fundamental steps that AMUCSS is taking towards improving the quality and timeliness of management information upon which managers of microbanks and AMUCSS general management should depend in their day-to-day decision-making. It will be important to continue this process of improving the timeliness and reliability of management information, including implementation of basic, standardized accounting system.

In quarter 3, AFIRMA began supporting information system implementation through a local provider to help AMUCSS to standardize accounting process and rules to improve quality and timely account information and reports. The project also sponsored management training for AMUCSS microbank managers through a local service provider, by cost-sharing participation of 10 middle managers in general management training.

In quarter 4 AFIRMA plans to mobilize internal control specialist Martin Yedra, a local consultant, to help AMUCSS to implement greater internal controls among the 7 rural microbanks of AMUCSS. Rafael Tejeda of AFIRMA subcontractor Quisqueya Finance, who participated in the diagnostic phase and subsequently provided training through ProDesarrollo on internal and external audit standards, will work with Mr. Yedra to ensure that AMUCSS is following best practices in its implementation of internal control mechanisms.

6. Fondo 5 de Mayo

In June Fondo 5 de Mayo (F5M) hosted a Visit from USAID Deputy Administrator Fredrick Schieck, USAID/Mexico Mission Director Ed Kadunc, CTO Elizabeth Bauch, and Financial Specialist José Luis Vásquez, members of the AFIRMA team and others at their headquarters in Puebla. F5M President Manuel Alonzo and the management team accompanied the USAID group to visit microenterprise clients and a F5M branch office, followed by the formal recognition of AFIRMA support to F5M through a press conference with the Governor of Puebla Lic. Mario Marín Torres.

Robin Young began working with F5M on a comprehensive diagnostic of the institution's microcredit product, the first area in which F5M requested assistance. Although Ms. Young is in the process of finalizing her report, her preliminary recommendations based on discussion and surveys with staff and clients include making the lending operations more flexible in order to increase productivity and client responsiveness, developing a pilot individual lending product, improving staff incentive schemes, and reviewing the strategic plan. AFIRMA is in discussions with F5M on support to develop strategic and business plans.

AFIRMA Training Specialist Claudette Martinez made preparations for F5M's study tour in July (quarter 4) to Peru. F5M Management will visit MiBanco, Caja Municipal de Ahorro y Credito de Arequipa with DAI's microfinance consultant Carlos Paredes (a Peruvian citizen) to facilitate the tour. Also planned for July is assistance with adjusting the management information system, given changes recommended through Ms. Young's work. DAI's Senior IT specialist Gabor Simon was identified for the work. Additionally, in support of Ms. Young's work to define adjustments to the lending methodology, AFIRMA will contract Katie Kohlstedt, a junior American microfinance consultant who lives in Mexico, to carry out analysis of the competition in Puebla and to facilitate and analyze client satisfaction surveys developed by Ms. Young.

7. Pro Mujer Mexico

There was a delay in beginning work with ProMujer due to their desire to modify the standard partnership agreement that AFIRMA and USAID has signed with each institution. Following ProMujer's consultations with its board and AFIRMA's consultations with USAID, ProMujer elected to sign the standard document.

Work began with DAI consultant Hillary Miller-Wise devising a comprehensive approach to market research that includes, among other elements, analysis of competition, branding, and client satisfaction. Ms. Miller-Wise coordinated with ProMujer to carry out a competitive bidding process to hire a local marketing firm that could support this work. The marketing and market research firm Serta was selected through price and technical criteria to help implement the market study.

Also, Brooke Jones the DAI Associate responsible for AFIRMA in the home office was identified to assist with this activity given her experience with client surveys and analysis of market information with FINCA Peru.

Additional assistance will likely be necessary to help ProMujer devise a strategy for its management information systems, which was highlighted as a weak point during the diagnostic phase, and it appears little progress has been made in this area since then.

8. FINCA Mexico

FINCA Mexico requested assistance from Carlos Paredes to analyze the appropriateness of the SIEM system (the management information system that all FINCA affiliates use) for FINCA Mexico given its growth pattern and plans for modifications to internal processes and procedures, MIF policies and system security norms and rules.

Johnny Velasco a Bolivian specialist in lending methodologies, with emphasis on the village banking methodology was scheduled to begin work with FINCA in June, but was delayed due to visa issues in Bolivia. Mr. Velasco arrived in July, and will carry out a comprehensive review of internal processes and procedures in order to streamline them where possible, and propose an operations manual that includes the recommended operational procedures.

Felipe Sandoval a Mexican expert in process is reviewing FINCA's manuals and process for the administrative and accounting areas to improve back office processes and procedures. FINCA and AFIRMA are also coordinating to prepare a new SOW to analyze FINCA Mexico's options for converting to a regulated microfinance institution under the *Ley de Ahorro y Credito Popular*.

9. FinComún

Given FinComun's planned growth and current sources of funding, the MFI has identified increased savings mobilization as a long-term priority. AFIRMA worked with FinComun General Manager Vicente Fenoll to develop a scope of work and identify a consultant to assist them with their savings approach and products. AFIRMA brought in Willy Escobedo, former General Manager of *Caja Municipal de Ahorro y Credito Arequipa* to do a savings product diagnostic and help FinComun adjust their approach and products. Mr. Escobedo's work exceeded expectations established in the scope of work. In addition to the work outlined in his SOW that included proposed changes to FinComun's products, Mr. Escobedo made specific, practical recommendations on FinComun's overall approach to savings mobilization. His work was very well received among FinComun management.

Another priority area identified with FinComun was the need for a comprehensive risk management approach. AFIRMA identified Risk Management Expert Max Errazuriz, a Chilean expert who has worked with DAI on the USAID funded microfinance project in Ecuador, to help FinComun establish a better approach to risk management. Mr. Errazuriz will continue to work with FinComun over quarter 4 to identify top priorities in risk management and help develop the internal systems, structures and planning necessary to manage risk effectively.

10. CAME

AFIRMA's initial focus with CAME has been to assist with final implementation of the FinMas management information system software (purchased from Bolivian provider Innova). Together with CAME, AFIRMA identified Miguel Angel Garcia, who has substantial experience with Innova and has worked with CAME in the past, to carry out the consultancy, scheduled to begin in July.

Additionally, AFIRMA and CAME have agreed on a scope of work and AFIRMA staff will work to support CAME's commercial operations area to carry out operational planning in accordance with CAME's existing strategic plan, and to assist CAME managers to carry out the plan. AFIRMA and CAME will identify a consultant early in quarter 4 who can implement the project. CAME has also requested project support to develop an expansion plan and approach to entering new regions and opening branch offices. AFIRMA will discuss the work and possibilities for assistance with USAID and CAME in quarter 4.

11. Caja Libertad

Chief of Party Fernando Fernandez took Services Director César Izurieta Moreno, Operations Manager Francisco Ramírez García, Credit Manager Raúl Martínez de la Piedra, Credit Process Specialist Bertha Obregón and Marketing Manager Susana León Hernández on a study tour to Ecuador, where they met with Banco Procredit (formerly Sociedad Financiera Equatorial - SFE), Banco Pichincha, Banco Guayaquil, Cooperativa COOPROGRESO, Credit Bureaus and the Ecuadorian Superintendency of Banks. Having returned from Ecuador with new ideas about how to serve microenterprises from its existing nationwide presence in Mexico, Caja Libertad quickly defined planning to develop and launch microcredit product. DAI microfinance and banking consultant Robin Bell and Fernando Fernandez held initial meetings with Caja Libertad to define a long-term strategy to roll out successful microfinance products. Ms. Bell will provide ongoing assistance over the coming months to design and roll out the new microfinance product line with Caja Libertad.

Another priority area for Caja Libertad is a relative mismatch of the tenors of their assets and liabilities. In general terms, Caja Libertad mobilizes short-term savings (site deposits) and makes 2-3 year loans on average. Part of this mismatch will be addressed with the addition of a microcredit product that is shorter in term (6-months, for instance). On the liability side, in quarter 4 AFIRMA will assist with adjustments to Caja Libertad's savings products with help from savings specialist Vicente Avalos.

12. Compartamos

Compartamos has had a great deal of success with its primary product "Generadores de Ingreso" the village bank lending product. Consistent with their strategic plan and the AFIRMA diagnostic, Compartamos identified the need to develop new products and to improve overall efficiency and productivity. AFIRMA, through subcontractor Acción Internacional, of which Compartamos is a long-standing affiliate, began addressing these areas in quarter 3.

The Acción team, led by Acción Vice President Monica Brand, includes product development specialists Raul Gomez, and Mery Solares, as well as individual lending expert Wilmer Guevara. The team will work with Compartamos to develop new products for housing improvement, refine the current individual lending product offering, and improve efficiency with which it is managed and incorporated into Compartamos' national branch structure. As part of the new product development, Ms. Brand will work closely with Compartamos staff not just to develop and refine products, but also to train staff on the process of new product development so that it is internalized and that future products can be developed internally.

Compartamos has also requested assistance with the conversion from a specialized finance company (SOFOL - *Sociedad Financiera de Objeto Limitado*) to a bank. This is to be discussed with Compartamos in quarter 4.

Task One Indicators

The indicators are shown in Table 2 in consolidated form, although most are included in the charts that follow.

Table 2 – Task One Indicators

Indicator	LOP Target	Baseline (Dec. 2004)*	June 2005	Variance
1.0 Strengthen the institutional capacity of MFIs				
I.1. Number of active clients	Increase of 500,000 active clients	455,708	533,895	78,187
I.2. Rural clients	No specific targets set	TBD		
I.3. # of loans to female borrowers	No specific targets set	TBD		
I.4. Number of loans < USD \$400	No specific targets set	TBD		
I.5. Increased Points of Service	Increase points of service by 50%	TBD		
I.6. Financial & Op. Sustainability	All partners Financially Sustainable	See Figure below		
I.7. Operating Expense Ratio	All partners improve efficiency	See Figure below		
I.8. Loan officer productivity	All partners improve productivity	See Figure below		
I.9. Portfolio-at-risk > 30 days	< 5% for all AFIRMA partners	9 under 5%		
I.10. Portfolio write-off ratio	Minimize. No specific targets set	N/A		
I.11. Compliance w/ reg. standards	All AFIRMA partners meet requirements	TBD		

Nathanael Bourns worked with AFIRMA to develop an approach to tracking indicators and monitoring project performance. In July Francisco Hernandez, who worked with DAI for five years in El Salvador tracking indicators, will work with Mr. Bourns to obtain and analyze information from the 12 partner MFIs. AFIRMA has proposed to track the following categories of indicators for Task 1:

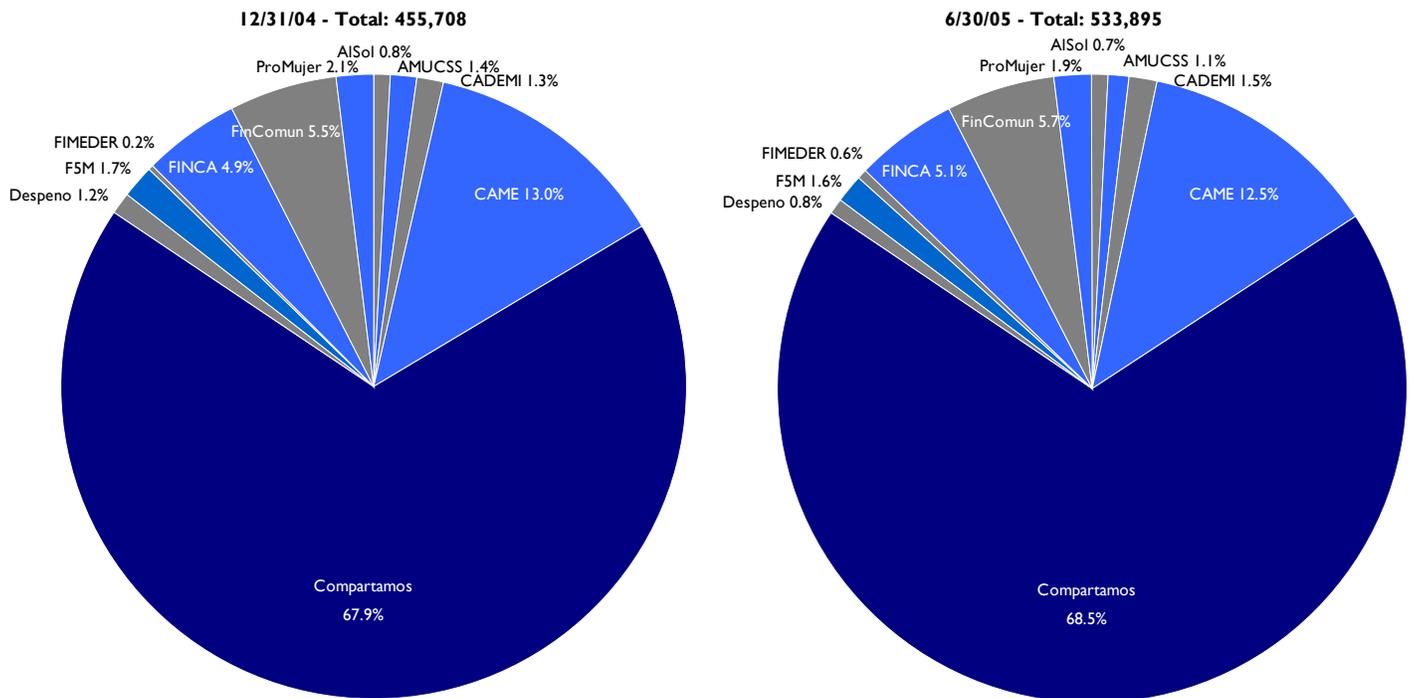
- **Outreach** – Indicators measure MFIs' performance serving greater numbers of clients among underserved populations with loan, deposit, and other services.
- **Sustainability** – Indicators seek to gauge MFI ability to remain in the market in the long-term, thus providing clients with ongoing access to finance.
- **Efficiency & Productivity** – important to measure and improve since Mexican MFIs are inefficient by regional standards, and inefficiency is passed to clients in high interest rates.

- **Portfolio quality** – Portfolio quality indicators monitor the performance of the MFI’s principal asset, the loan portfolio.

As shown in the “market share” charts below, Financiera Compartamos served around two-thirds of all microcredit clients among the 11 MFIs for which data is included.² This proportion increased slightly, as Compartamos grew by 18% from 309,637 to 365,710 from December 2004 to June 2005 while the other 10 MFIs grew by 15%, from 146,071 to 168,185 total active credit clients. Overall, the 11 MFIs were serving 78,187 more clients in June 2005 than they had been in December 2004.

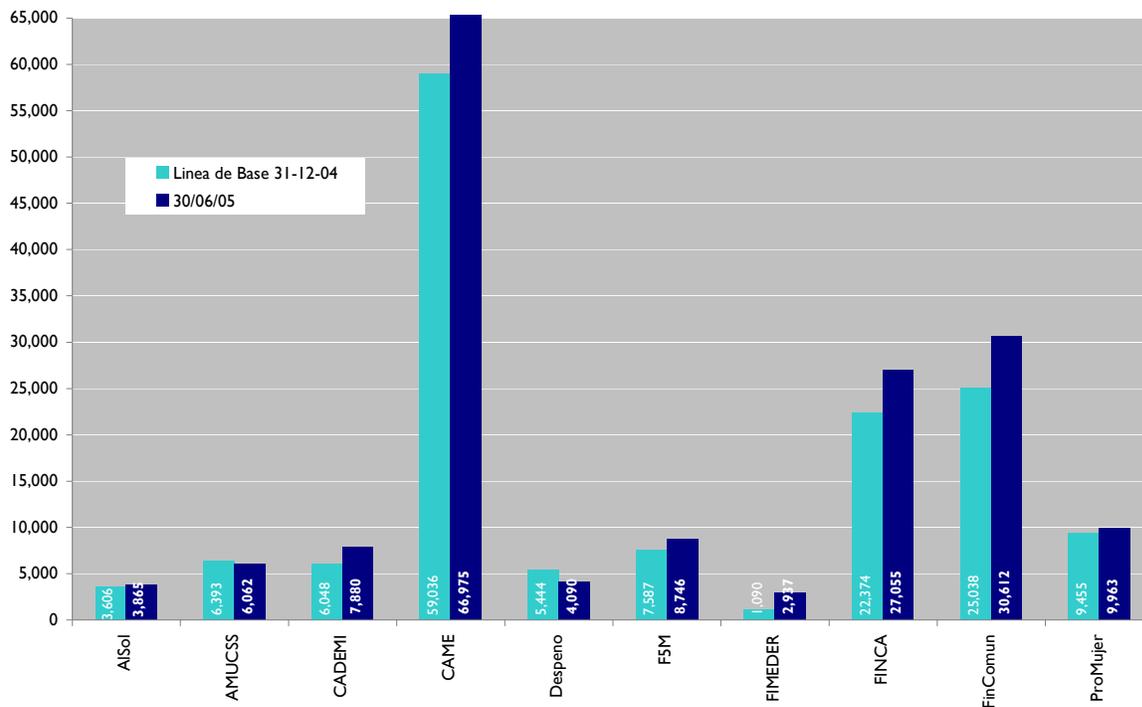
“Market share” 11 AFIRMA Partner MFIs December 2004 & June 2005

(Caja Libertad not included)



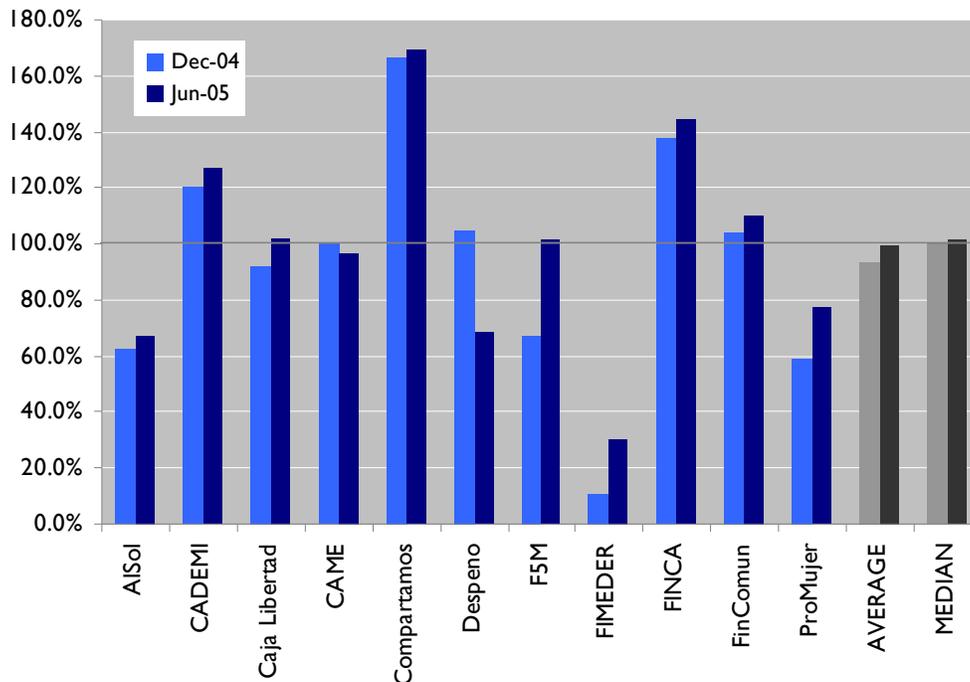
² It is worth noting that data for Caja Libertad is not included in the figures cited here for number of clients. AFIRMA is planning to assist Caja Libertad to segment their current portfolio. AFIRMA’s preliminary estimates are that as of June 2004, Caja Libertad served around 15,000 micro and small enterprise clients with traditional cooperative credit products. Data for FINCA are for March 2005. Due to change in systems, the data for June are not yet available.

Active Credit Clients (excluding Compartamos & Caja Libertad)



Over the quarter both the median and the average institution among the 12 attained financial self-sufficiency³, and although most improved, CAME slipped slightly while Despeno's financial results deteriorated significantly

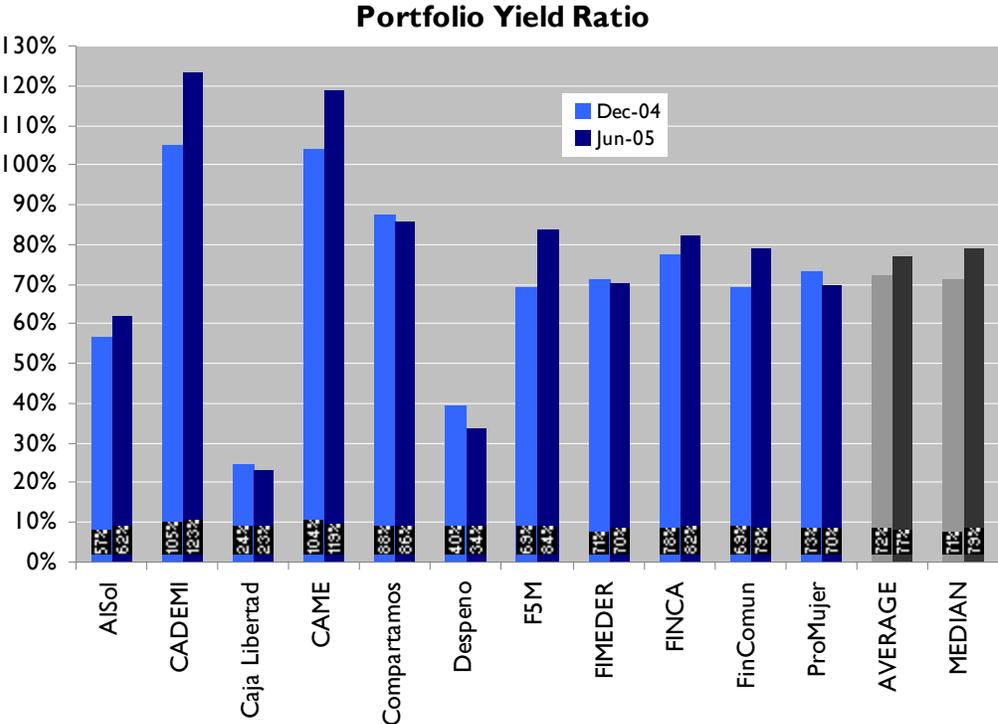
Financial Self-Sufficiency



³ The standard CGAP definition is applied: operating revenue (excluding donations) is divided by adjusted operating expenses, where adjustments are made for inflation, subsidized cost of funds, insufficient provisions, and in-kind donations.

As the financial Self-sufficiency chart shows, there is significant variance among the partner institutions in terms of their ability to cover adjusted operating expenses with operating revenues.⁴ Relatively high levels of financial self-sufficiency have been attainable in Mexico due in large part to the very high levels of portfolio yield that the MFIs enjoy, as shown in the portfolio yield ratio chart below.

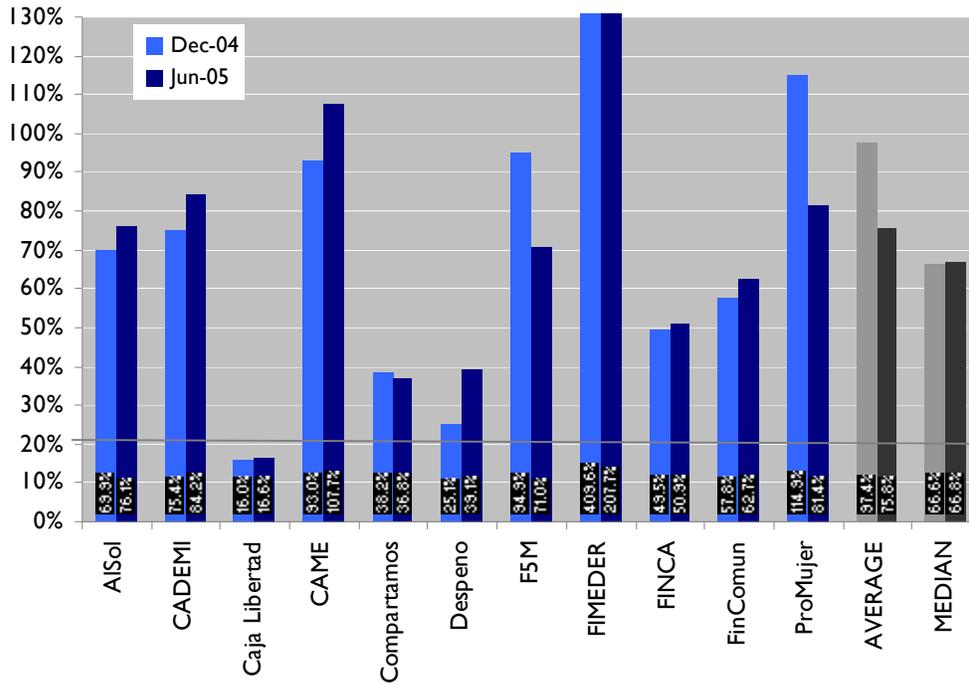
Exceedingly high levels of portfolio yield reflect the higher average interest rate charged to clients in Mexico as compared to other countries in the region. The 32 MFIs that MicroRate tracks in Latin America had, on average, a portfolio yield of 42% as of June 2004, well below the average of 77% among 11 AFIRMA MFIs in June 2005 (also, the MicroRate averages are pulled up by Compartamos and FinComun, which are included in the MicroRate 32).



In general, the high portfolio yields cover cost structures in need of substantial gains in productivity and efficiency, as reflected in the operational efficiency chart. As of June 2005, both the average and the median operational efficiency (personnel and administrative expenses divided by average gross portfolio) among the 11 MFIs is over three times higher (less efficient) than the regional average reflected in the MicroRate 32 of 21% (for June 2004).

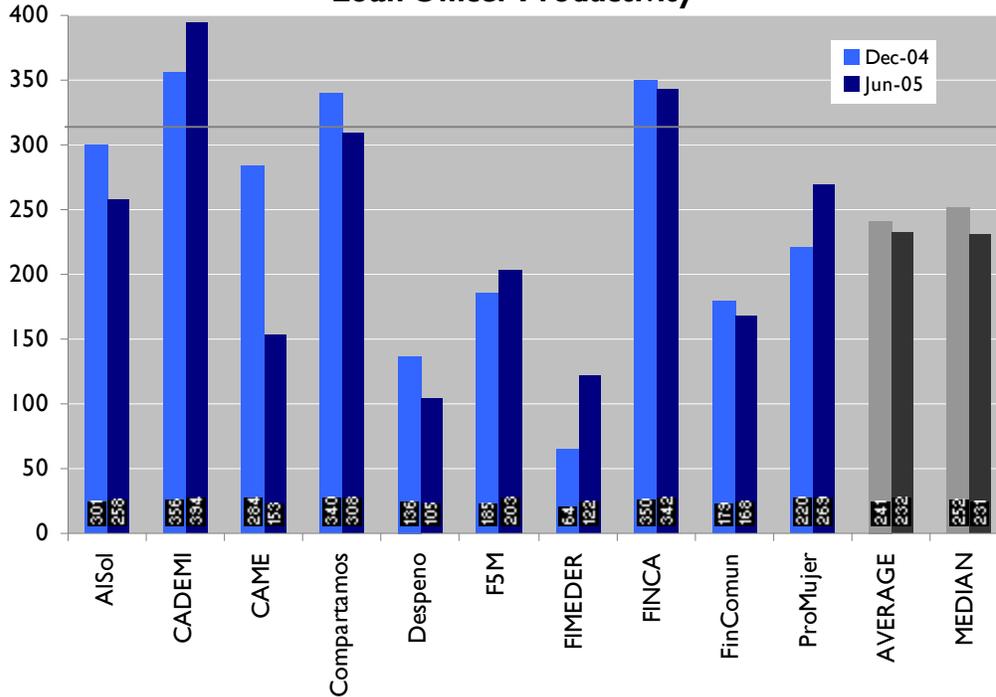
⁴ AMUCSS has not yet implemented a standard accounting system among its microbanks and financial information was not available as of July 2005. Also, it is important to note that AISol uses cash-based accounting, as opposed to accrual accounting used among the other 10, which makes its indicators un-comparable to the others, but can still be meaningfully compared against prior periods.

Operational Efficiency Ratio

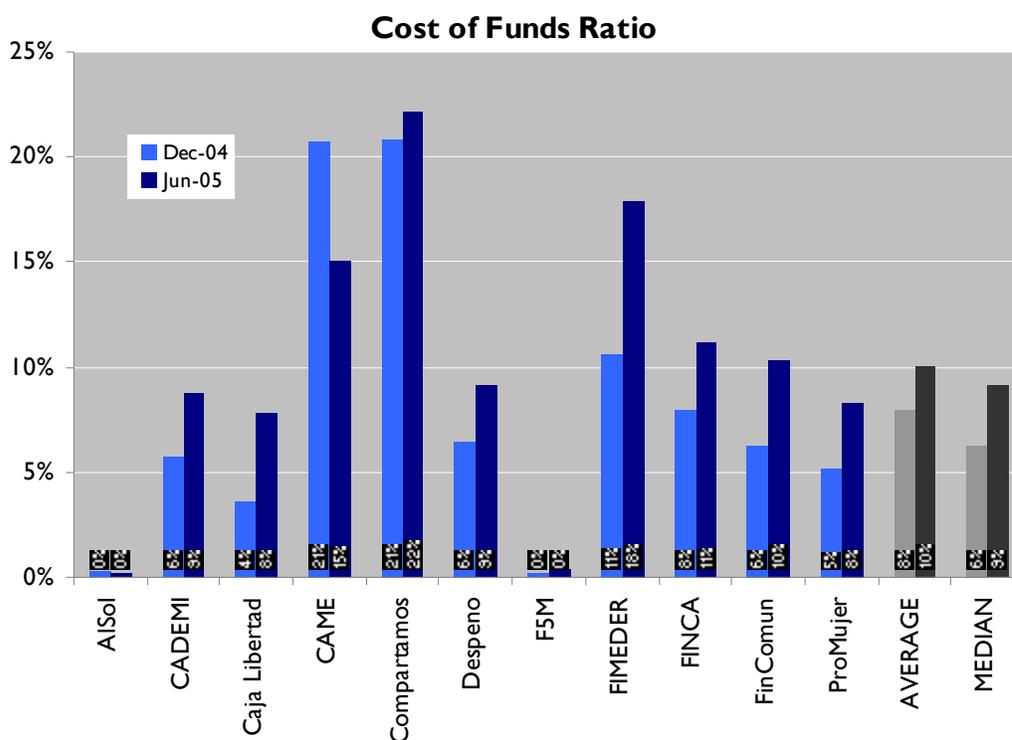


As shown in the loan officer productivity chart, few of the partner MFIs have levels of loan officer productivity that reach international standards (the institutional average for the MicroRate 32 is 312 clients per loan officer).

Loan Officer Productivity



Finally, the cost of funds ratio (interest expense/average funding liabilities) has risen for almost all of the partner MFIs, except CAME and AISol, but the high interest rates charged can be explained by the need to pay for inefficient cost structures, rather than a rising cost of funds.



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

The development of a MFI support services industry is critical to the growth of rural and microfinance in Mexico, and AFIRMA will build upon and improve the supply of training, technical assistance, audit, research, product development, and other services as demanded by the MFIs/RFIs.

AFIRMA will begin specific planning for this area in quarter 4, focusing first on understanding the market for support services in Mexico and then directing initiatives towards ongoing, sustainable (i.e. commercial) service provision. Starting in July, USAID Intern Virginia Brandon will work with AFIRMA Training Specialist Claudette Martinez and Senior Microfinance Specialist Ricardo Calvo of Acción International to conduct a survey to better understand the current supply and demand for local services to MFIs in areas such as:

- External Audit, to ensure that MFIs are receiving quality audits that are adjusted to the particular conditions of microfinance, and that the project and investors receive reliable information;
- Credit Information, in particular using credit bureau information, developing credit decision-making models and scoring;
- Training in core operational and back-office areas (e.g. credit analysis, risk management, processes for new product development);

- Consulting, especially technical assistance in areas where there is likely to be an ongoing market for the services, for example:
 - Micro- and rural finance strategy and business planning;
 - Market research;
 - Information technology;
 - Legal and regulatory compliance and conversion; and,
 - Human resource management.

AFIRMA will use the survey as a baseline for this activity as well as a means to develop training programs tailored to the needs of partner MFIs. AFIRMA plans to follow up on the survey to track indicators.

Table 3 – Task Two Indicators

Indicator	LOP Target	Baseline	Year 1 Target	Results (variance)
2. Develop a local, commercially-based MFI support services industry				
2.1. Number of quality service providers	> 1 quality service provider in each key area	TBD		
2.2. Unsubsidized MFI purchase of local services	> 6 MFIs procuring services at full cost by Year 5	TBD		

3.3 DEVELOP INNOVATIVE PRODUCTS & TECHNOLOGIES TO EXPAND ACCESS TO RURAL FINANCIAL SERVICES & REMITTANCES

AFIRMA will work to stimulate the introduction of new technologies, approaches, distribution channels, or other elements that improve an institution's capacity to reach underserved populations, especially rural clients. An innovative product is one that is new to the Mexican market, and innovation also extends into the back office and can include innovative systems, procedures and arrangements that directly impact performance.

An approach for this task will be more fully defined as part of the retreat with AFIRMA staff and USAID. At the Mission's request, AFIRMA consultant Nathanael Bourns attended the Multilateral Investment Fund/Inter-American Development Bank Remittances Conference held in June 2005 and he can report back to the internal team at the retreat on promising approaches to expanding access to remittances.

Table 4 – Task Three Indicators

Indicator	LOP Target	Baseline	Year 1 Target	Results (variance)
3. Develop innovative products & technologies to expand access to rural financial services & remittances				
3.1. Sound innovation process	Partners apply sound approach to innovation	TBD		
3.2. Increased outreach due to innovation	5 effective innovations supported	TBD		

3.4 STRENGTHEN THE POLICY ENVIRONMENT FOR MICRO- AND RURAL FINANCE

Under this task, AFIRMA will work with the *Comisión Nacional de Bancos y Valores* (CNBV) and Federation Committees to develop risk-based supervision appropriate to microfinance, in particular, proper evaluation of portfolio-at-risk and provisioning requirements for microfinance portfolios. The goals of technical assistance and training will be first to increase the CNBV's capacity to supervise Federation Committees to which it delegates authority, as well as its capacity to supervise microfinance operations directly. Second, AFIRMA will train the Federation Committees to supervise their member institutions.

AFIRMA is planning a small seminar to kick off efforts under this task. The conference would include representatives from MFI stakeholders, the CNBV and Federation Committees, and international experts from AFIRMA subcontractor International Consulting Consortium, including ICC Director Ramon Rosales, an internationally recognized expert on the topic (to be confirmed).

Table 5 – Task Four Indicators

Indicator	LOP Target	Baseline	Year 1 Target	Results (variance)
4. Strengthen the capacity of the CNBV and federation committees to supervise RFIs and MFIs				
4.1. Workplans set for key areas with CNBV	Annual workplans established and implemented	TBD		
4.2. Improved supervisory capacity	Federations Committees meet requirements	TBD		
4.3. Risk-based supervision for microfinance	Risk-based supervision adopted by end of project	TBD		

3.5 STRENGTHEN THE MICRO- AND RURAL FINANCE INDUSTRY

The primary goals of this task are to promote microfinance sector initiatives along with GoM agencies, such as *Financiera Rural* and *Bansefi*, or associations such as *ProDesarrollo*. AFIRMA efforts for this task include supporting initiatives with GoM agencies, private sector stakeholders in microfinance, and other industry initiatives.

Initiatives with GoM agencies

DAI Consultants Robin Bell and Miguel Davila carried out a comprehensive diagnostic of the government rural finance company *Financiera Rural*. The consultants were asked to return to complete areas of the diagnostic that *Financiera Rural* felt were lacking in detail, specifically, the training needs assessment, and were scheduled to do so under extended scopes of work in July.

Initiatives with private sector stakeholders in micro- and rural finance

AFIRMA continued to work closely with *ProDesarrollo*, planning training events in the following areas:

- Internal control and audit standards – Two international specialists: Alejandro Guevara the manager of internal audit at *Caja Municipal de Arequipa* (Peru) and Rafael Tejada of *Quisqueya Finance* led the training, supported by local audit firm BDO and local consultant Rene Garcia. This program was cost-shared with The Ford Foundation. This training took place the first week of July (quarter 4) and was very well received by participants. The program includes a

follow-up consultancy to accompany the implementation of internal control systems within partner MFIs, for which Alejandro Guevara and Rafael Tejada will return in August.

- Costing Analysis – In coordination with ProDesarrollo AFIRMA will hire costing specialist Lorna Grace to adapt and deliver the costing analysis training she helped design with the donor consortium for microfinance - Consultative Group to Assist the Poorest (CGAP). The training will be delivered in August.
- Leadership in Microfinance – As a follow-on to the annual conference that ProDesarrollo organizes on Leadership in microfinance, AFIRMA will contract Susana Barton of Acción International, Juan Buchenau an expert in individual lending technologies, and possibly another consultant to deliver modules of the leadership program geared towards MFI managers. The leadership conference will be delivered in November 2005.

Other Industry Initiatives

AFIRMA subcontractor The Ohio State University, led by Dr. Claudio Gonzalez-Vega began work on a rapid assessment of the breadth and variety found in rural financial markets in Mexico. The assessment will be conducted by a team of researchers from the Rural Finance Program at OSU and their Mexican collaborators, between June and October of 2005. AFIRMA arranged for Dr. Gonzalez-Vega to present the team’s research design and approach, and to respond to comments and questions from AFIRMA partners at the first project quarterly meeting on July 22, 2005.

It is worth mentioning that OSU was also chosen to implement the USAID-funded TIES program in coordination with CIDE, and that one of their tasks will be to develop a microfinance curriculum. AFIRMA will coordinate with OSU and CIDE going forward.

Table 6 – Task Five Indicators

Indicator	LOP Target	Baseline	Year 1 Target	Results (variance)
5. Improve the enabling environment for the rural and microfinance industry				
5.1. Capacity for quality sector initiatives	Participants judge initiatives to be of quality; Increased Local roles over time	TBD		
5.2. Useful market information	Client MFI satisfaction with information service	TBD		
5.3. Benchmarking system	Global-standard Benchmarking system established	TBD		

4. PROJECT MANAGEMENT

Over the quarter, AFIRMA COP Fernando Fernandez and the local team with support from DAI home office coordinated a high volume of national and international consultants to work on the technical tasks outlined above. Other key developments in project management over the quarter included the following:

- **Addition of Willy Escobedo as Senior Microfinance Specialist.** Mr. Escobedo replaced Guillermo Caal, strengthening AFIRMA's technical capacity. Mr. Escobedo brings to the project over 20 years of experience in microfinance in Latin America, having played an important role in developing the renowned *Caja Municipal de Ahorro y Credito (CMAC)* System in the competitive Peruvian microfinance market, and more recently serving as General Manager of *CMAC Arequipa* one of the region's most successful MFIs. Prior to joining AFIRMA long-term, Mr. Escobedo had worked short-term on the USAID-funded SALTO microfinance project that DAI manages in Ecuador and for AFIRMA in quarter 3, he carried out a technical consultancy with FinComún to help adjust their savings products and overall approach to savings mobilization. Mr. Escobedo will continue to provide direct technical assistance to partner MFIs as needed, while also managing the work of short-term national and international consultants.
- **Management support from Nate Bourns.** Mr. Bourns supported project management on an intermittent basis over the course of quarter 3. Mr. Bourns developed an approach to monitoring and evaluation of the project, and began implementing the tool designed for M&E of Task 1. In July DAI consultant Francisco Hernandez worked with Mr. Bourns to obtain performance data from AFIRMA partners and consolidate and analyze the data. Mr. Bourns will officially join the long-term AFIRMA team in August, having been approved as Deputy Chief of Party through the contract modification that was finalized on July 15, 2005 (quarter 4).
- **Addition of administrative local staff** – Given the volume of administrative work required to mobilize and support a large and growing number of national and international consultants, AFIRMA obtained approval to (managing to other direct cost line item of the budget). The new support staff will be hired in quarter 4.
- **Support from DAI Home Office Associate Brooke Jones planned.** Ms. Jones is assigned to the AFIRMA Project and will work with local AFIRMA staff to ensure the proper procedures are being followed as the project identifies, contracts, and mobilizes technical consultants. Ms. Jones will also support ongoing marketing work with ProMujer, given her experience in this area with FINCA Peru.

4.1 AFIRMA BUDGET VS. ACTUAL EXPENSES

Below the original contract budget is compared to actual costs incurred as of June 30, 2005, by contract line item. The Budget amount reflects the new budget from Contract Modification I, signed on July 15, 2005.

5. AFIRMA PRIORITIES FOR NEXT QUARTER

AFIRMA's priorities for the next quarter (quarter 4, year 1) include:

- Hold first quarterly meeting with AFIRMA Partners, and obtain and process feedback from all stakeholders in order to inform the content, focus and logistics of future project meetings.
- Hold internal project retreat with new AFIRMA CTO Geoffrey Chalmers other USAID colleagues (depending on interest and availability), and the full AFIRMA team, including new full-time team members Willy Escobedo (Senior Microfinance Specialist) and Nathanael Bourns (Deputy Chief of Party). The retreat is tentatively planned for August 25, 2005.
- Begin activities under Task 2, starting with a survey of partner MFIs regarding the support services industry, followed by brief analysis of the service providers themselves.
- Work with the CNBV and other stakeholders to plan activities for Task 4.
- Finalize the rapid rural finance assessment currently being prepared by OSU and plan next steps under Task 5 (enabling environment).
- Prepare the second annual work plan for USAID approval

AFIRMA Project
Homero 203, piso 7 of. 703 y 704
México, Distrito Federal, DF | 1570
México