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MICROENTERPRISE INNOVATION PROJECT (MICROSERVE)

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USAID/MEXICO MICROENTERPRISE STRATEGY

Delivery Order No. 800

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USAID/Mexico Microenterprise Strategy

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MicroServe Delivery Order: 800

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Project No. PCE-I-00-95-00034-00
Microenterprise Development Office
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TABLE OF CONTENTS

Foreword		1
SECTION I	Strategy Summary and Results Framework	2
	I-A. Rationale for Strategy	2
	I-B. The Development Hypothesis	3
	I-C. The Results Framework	5
	Strategic Objective	5
	Intermediate Result No. 1	6
	Sub-IR 1.1	6
	Performance Measurement Indicators	6
	Intermediate Result No. 2	6
	Sub-IR 2.1	6
	Performance Measurement Indicators	6
	Sub-IR 2.2	8
	Performance Measurement Indicators	8
	Sub-IR 2.3	8
	Performance Measurement Indicators	8
	Intermediate Result No. 3	9
	Sub-IR 3.1	9
	Sub-IR 3.2	9
	Performance Measurement Indicators	9
	Sub-IR 3.3	10
	Performance Measurement Indicators	10
	Intermediate Result No. 4	11
	Sub-IR 4.1	11
	Performance Measurement Indicators	11
	I-D. Customers	12
	I-E. End of Strategy Results	13
SECTION II	Support for Institution Building	14
	II-A. Strengthening Microenterprise Finance Institutions	14
	II-B. MFI Management	15
	II-C. Support of Mexican Initiatives	16
	II-D. Rural Microenterprise	17
	II-E. Filing Critical Knowledge Gaps	20
	1. Relationships between Microenterprise and Migration	21
	2. Rural Microenterprise Service Institutions	22
	3. Importance of Microenterprise	22
	II-F. Other Institution-Building Initiatives	22
	1. Credit Bureau	22
	2. A System of Self-Regulation	24
SECTION III	Implementation Plan and Budget	25
	III-A. Program Management Options and Mechanisms	25
	III-B. Timing of Implementation	28
	III-C. Illustrative Budget	30
ANNEX 1	"The Socio-Economic Environment"	
ANNEX 2	"The Financial Sector"	
ANNEX 3	"Microfinance Institutions and their Support Organizations"	
ANNEX 4	"Results Framework Diagram"	

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USAID/MEXICO MICROENTERPRISE STRATEGY

SEPTEMBER 2000

Foreword

"Mr. Arturo Martinez Romero is a member of 'Grupo Progreso', a cooperative credit union which serves farmers and microenterprises in the state of Chihuahua. When his father's backyard carpentry business could not support their poor family, Mr. Martinez had to migrate to the U.S. looking for work. He spent five years working in restaurants and paint shops, until he managed to save up enough money to return with cash in hand to his hometown of Delicias, Chihuahua.

Mr. Martinez continued to work in the family carpentry business, but he dreamed of starting his own carpentry shop. Four years later, Mr. Martinez sought a loan to start his business, from a local moneylender. At 10 percent interest per month, however, the moneylender's rates were too high. Mr. Martinez applied for a loan at a commercial bank, but he could offer neither substantial collateral, nor maintain a minimum balance in a checking account at that bank, as they required.

Mr. Martinez learned of the cooperative credit union "Grupo Progreso", where he was able to obtain a $2,000 loan without having to provide a lot of collateral, or take time from his business to attend cooperative meetings. With this loan, Mr. Martinez was able to buy the tools he needed to open his own carpentry shop. He received subsequent credit from Grupo Progreso to increase his inventory and buy more specialized tools.

Mr. Martinez' shop is not yet finished. It still lacks floor tiles and electricity. But Mr. Martinez is pleased with what he has been able to achieve so far. He plans to ask Grupo Progreso for future technical assistance to create his business accounting system; legal assistance to obtain title to his house and shop; and management and financial assistance to make his business more profitable.

Mr. Martinez stated that, thanks to financial support from the credit union, he will not have to return to the U.S. in the future. In fact, he said if he had received such support earlier, he never would have migrated to the U.S. in the first place."[1]

[1] Quote from loan application records of the cooperative credit union Grupo Progreso, State of Chihuahua.

I. STRATEGY SUMMARY AND RESULTS FRAMEWORK

I-A Rationale for Strategy

Several issues have directed the Mexico Mission (USAID/M) to develop a microenterprise strategy:

Agency and Regional Policy Objectives: According to the Latin America and Caribbean (LAC) Bureau's new Regional Microenterprise Strategy, an estimated 200 million people live below the poverty line in the LAC region. Of Mexico's 100 million population, more than half live below the poverty line. This number is equivalent to 25 percent of the region's total poor. Therefore, equitable economic growth in Mexico has the potential for a meaningful impact on the region's poverty status, as well as on Agency and Summit of the Americas objectives for poverty alleviation.

U.S. Government Foreign Policy Objectives: The 1995 peso crisis, followed two years later by the Asia economic crisis, created the most severe recession in Mexico's history. The nation's rising GDP growth rate is due almost entirely to the export-oriented *maquila* industry. This industry is oriented to the U.S. market, and has few backward linkages to Mexico's domestic economy. As a result, the benefits of Mexico's macro-economic growth have not been felt by the vast majority of Mexicans. The economic status of most Mexicans has actually worsened. A 60 percent drop in real wages since 1995 drove the numbers of people living below the poverty line from 39 percent in 1994 to as much as 56 percent in 1998. While the rate of job growth appears to be on the rise, so is Mexico's population. And the domestic economy can absorb no more than 70 percent of the one million new Mexicans seeking jobs each year. The informal economy has grown at least 30 percent since 1995, suggesting that this microenterprise-dominated sector is now an essential source of jobs and income for Mexico's poor. Although the Government of Mexico (GOM) absorbed nearly 60 percent of commercial banks' bad debt from Mexico's catastrophic 1995 peso devaluation, the financial sector remains severely under-capitalized and fragile. The GOM's billion-peso bank bail-out must be paid for out of public revenues for at least the next decade. Thus, both the private financial and public sectors have nothing to invest in growth for the benefit of most Mexicans.

Mexico's economic problems directly impact the United States. The U.S. trade balance with Mexico turned sharply negative when demand for U.S. imports fell in 1995. Further, rising numbers of Mexicans crossing the border looking for work in the U.S. has become a high-visibility issue in the 2000 presidential election campaigns of both countries. Recognizing that the root of these problems is lack of opportunity in an increasingly inequitable economy, the U.S. Country Team added a new section to its 1999 Mission Plan and Program (MPP) calling for U.S. Government (USG) support for Mexican economic growth. Among the specific activities identified in the MPP is promotion of microenterprise growth to help provide jobs and income to Mexico's poor. As the only USG agency with capability in this area overseas, USAID/M was tasked by the Country Team with leading implementation of the MPP's microenterprise component.

USAID/Mexico Strategic Objectives: Because of its size, the rapid destruction of its natural resource base, and the direct impact this has on Global Climate Change (GCC) and related natural disasters, the Agency has placed Mexico among the top ten priority countries in the world for environmental and energy conservation. The Agency is committed to investing a total of approximately $70 million in USAID/M's strategy for environmental and energy conservation by the year 2005. Thus, the Agency has a major stake in ensuring the success of USAID/M's environmental program.

Under its approved 1998-2003 Country Strategy, USAID/M has developed technically feasible models for environmental and energy conservation. In order to achieve Strategic Objectives (SOs) No. 1 and 2 for preservation of the environment and reduction of greenhouse gas emissions, respectively, it is essential that these models be adopted and replicated on a large scale. In order for this to occur, the models must be economically viable and self-sustaining. Taking the "green" side for example, people living in and near Mexico's many ecologically fragile areas cannot be relocated voluntarily or forcibly. Therefore, economically viable income alternatives must be provided which allow them to abandon destructive land-use practices, such as agricultural and forest exploitation, which drive Mexico's rapid environmental degradation. To this end, USAID/M and its Mexican partner organizations launched environmentally friendly microenterprises within selected protected areas covered under SO. 1. Experience to date has shown that people will move to income-earning alternatives; however, such a move requires considerable time, in addition to financial and other assistance to establish and operate microenterprises. Similarly, USAID/M's models for more efficient and renewable energy use are technically feasible, but they are not yet within the financial reach of large numbers of low-income people. Massive donor or GOM subsidies are not feasible to achieve widespread adoption of these models.

Mexico's cash-strapped commercial banks cannot provide credit for this new microenterprise market. In addition, other basic support services for microenterprises are not available. Given Mexico's size, its productive potential, and its expanding informal economy, the severe under-development of a microenterprise services sector is hard to comprehend. Microenterprise institutions and services that are taken for granted in other countries, such as Bolivia or El Salvador, simply do not exist in Mexico. Thus, the Mission concluded that it will be necessary to strengthen the institutional foundations for microenterprise growth in order to achieve the economic viability and wide-spread replication of its environmental and energy conservation models.

I-B . The Development Hypothesis

The lack of even a minimal institutional foundation for microenterprise services in Mexico severely constrains the growth of all microenterprises. The Mission's analysis indicates that a limited amount of carefully targeted technical advice and assistance could help remove some of the most critical institutional deficiencies. Strengthening the microenterprise service sector will help the Mission both stimulate microenterprise growth and meet its environmental SOs. A growing microenterprise sector will in turn increase employment and income opportunities for the low-income segment of Mexico's population, helping to alleviate their economic need to seek jobs and income through migration.

By focusing resources on institutional strengthening to serve selected segments of the low-income population, it is possible to maximize the increase in job and income opportunities through greater microenterprise productivity in addition to linking microenterprises directly to the formal economy, thus fueling another cycle of job and income growth for the low-income population. Increased job and income opportunities for the low-income population will help alleviate the inequitable distribution of economic benefits, which contributes directly to Mexico's high poverty rates.

In order for USAID/M's environmental and energy conservation models to be replicated on a large scale, they have to be self-sustaining. The environmental protection activities which USAID/M support include development of local microenterprise in order to give poor people viable alternatives to destructive land and energy-use practices. These microenterprises are unsustainable without adequate inputs of credit, training, and technical assistance. But Mexico's highly fragmented and very weak microenterprise service sector cannot provide such inputs without access to new capital and institutional strengthening services.

I-C. The Results Framework

This section gives an overview of Mission findings which shaped the proposed Strategic Objective and Intermediate Results for the microenterprise strategy. Detailed economic, financial, institutional, and other analyses and supporting data can be found in other sections of this document and the various annexes. A Results Framework Diagram can be found in Annex 4.

<u>Strategic Objective:</u> To strengthen the institutional base for sustainable microenterprise growth by supporting Mexican initiatives.

The institutional base for microenterprise support is very small and extremely weak in Mexico. There are, at most, 10 microenterprise service providers (MSPs), most of which are NGOs functioning as microenterprise financial institutions (MFIs). One or two very small umbrella organizations provide minimal informational services to the microenterprise service sector (MSS).

Reliable numbers are hard to come by, but estimates indicate that existing MFIs serve altogether no more than 100,000 low-income borrowers.[2] In a country of 100 million people, with half living in poverty, and an economically active population of 30-40 million, most of whom have no prospects of employment in the formal economy, this figure barely registers as microenterprise support. Donor resources — including those of USAID/M — have provided most of the financing for microenterprise in Mexico. The bulk of donor assistance has gone to the poorest of the poor, primarily women, while the majority of poor microentrepreneurs receive no support at all. Neither the GOM nor the commercial banking sector provide funds or services to microenterprises.

Most MFIs have reached the limits of their possible growth under the existing financial regulatory system. Some have decapitalized due to poor management of what donor resources they had. Some lack the technical know-how to move their organizations to a higher level of performance. These organizations are too small in terms of business volume to re-capitalize through their portfolios alone. The MFIs are starved for capital, and all have financial management weaknesses which stunt their growth and reduce their profitability. Almost no financial management training suitable for MFI staff exists.

<u>Intermediate Result No. 1:</u> Communication and collaboration among microenterprise finance and other service providers increased to define constraints to microenterprise growth and organize Mexican initiatives to address those constraints.

Mexico's existing statutes have created a highly fragmented financial system comprised of several different types of financial organizations. Each organization tends to have strong "turf" jealousies and is reluctant to cooperate with other MSPs, even for the good of the sector. This lack of cohesion makes it difficult to reach consensus on a definition of issues, or to mobilize efforts toward common goals for the future. It also places all MSPs in a very weak position in trying to conduct any sort of policy dialogue with the GOM. Thus, USAID/M will help promote

[2] Some claims of client base could not be verified, so the Mission believes the number of clients may be less.

increased interchange and cooperation among MSPs, with the aim of arriving at a working definition of what the vision of the sector should be for the future.

USAID/M does not expect to be able to bring all players to agreement by the end of the strategy period. The issues are too complex, and the habit of mutual suspicion too deeply entrenched to be resolved in such a short time. However, USAID/M can collaborate with interested parties already working in this area (e.g., Ford Foundation) to help Mexican partners increase practitioner dialogue, define a common agenda of priorities for growth of the sector, and mobilize support to carry out such an agenda.

<u>Sub-IR 1.1</u>: Mexican objectives for strengthening the institutional foundations for microenterprise growth defined and action mechanisms developed.

Experience has shown that any proposed strategy must be "owned" by the Mexican partners, and thus support Mexicans' own initiatives, or it will fail. The first step toward achieving this sub-IR was taken when the Mission presented the draft microenterprise strategy results framework to the group of Mexican MSPs that will provide the leadership for carrying out the strategy and will also become USAID/M's customers for financial support, training, and technical assistance under the strategy.[3]

Performance Measurement Indicators:

a. Mexican Working Group (MWG) constituted by interested microenterprise service provider institutions (financial and training/technical assistance).
b. Selected MWG members acquainted with best practices in microenterprise service provision through observation trips to other countries.
c. At least two workshops conducted on key issues constraining microenterprise growth for MWG members.
d. Based on conclusions from observation trips and workshops, MWG sets objectives, identifies priorities, and creates plans to create a supportive environment for microenterprise growth.

<u>Intermediate Result No. 2</u>: Selected microenterprise finance institutions' management ability strengthened to help increase and improve credit and financial services to microenterprise.

<u>Sub-IR 2.1</u>: Feasibility studied of MFIs joining an existing credit bureau or creating one to serve their specialized needs.

Performance Measurement Indicator: Feasibility study completed on steps needed for MFIs to join an existing credit bureau or create one to meet their needs.

No institutional support is available (e.g., credit bureaus or second-tier lenders) to MFIs, nor does consensus yet exist as to which institutions are most needed or the way in which such organizations should be created. The absence of support institutions acts as a brake on the

[3] Letters from partners requesting USAID/M assistance and committing their own support form part of this strategy.

growth of Mexican MFIs. However, Mexican partners strongly support either joining an existing credit bureau, such as Trans Union de Mexico, or determining what steps and conditions would be necessary to establish their own bureau. Access to the services of a functioning credit bureau would improve the financial viability of MFIs by controlling risk, which in turn would allow MFIs to extend resources to an expanded microenterprise client base. Under the strategy, assistance would be provided to carry out a pre-feasibility study which will determine the market and business conditions necessary for MFIs to join a credit bureau or create one for their specialized needs.

Sub-IR 2.2: Sustainable source(s) of capitalization accessed for microenterprise.

Performance Measurement Indicator: At least one source of readily accessible capital opened to partner MFIs for lending to microenterprise.

The lack of capital which is holding back lending by Mexico's commercial banking sector is also stifling growth for the few MFIs now operating. Absent major infusions of capital from donors or other sources, MFIs have very little chance of extending microenterprise financial services to a larger client base. Opening the door to new sources of capital for MFIs would be a major contribution to the future of microenterprise finance in Mexico.

USAID/M does not have funds to capitalize MFIs directly. However, some MFI partners are managing savings deposits which could be on-lent to microenterprises. Accessing these funds will require a variety of measures ranging from technical advice and financial management training to a Development Credit Authority (DCA) guarantee, all of which would enable MFIs to risk putting depositors' money out as loans to microenterprises. In addition, the public-sector National Savings Institute (PAHNAL) holds approximately $40 million in savings which could be made available for microenterprise lending under the appropriate arrangement.

Sub-IR 2.3: MFI's institutional capacity strengthened to increase microenterprise access to credit and financial services.

Performance Measurement Indicators:

a. Financial services training and technical assistance provided to select partner MFIs, in accordance with their identified needs for institutional strengthening.
b. Policies and working procedures designed and implemented within partner MFIs for cost-effective management, asset liability management, accounting, inventory control, and personnel management.
c. Cost-effective information systems in place in partner MFIs.
d. Additional mechanisms for reducing transaction costs designed and tested with MFI partners.

In-depth institutional analyses of partner MFIs revealed internal management weaknesses that seriously impede growth. MFI managers are operating without business plans, use information systems which are incomplete and unreliable, and maintain data systems that are vulnerable to error. Productivity of MFI staff is lower than the average in other countries. There is a clear need for high-quality training for MFI staff and technical assistance to help strengthen data, personnel, information and other management systems, and reduce operating and transaction costs.

There appears to be only one source of professional financial management training suitable for MFI personnel in Mexico: the Latin American Regional Training Institution, or COLCAMI. COLCAMI now operates (with IDB funding) as a Latin America regional effort, rather than a Mexico-specific program. Its courses of instruction need to be re-oriented to emphasize practical banking management aimed at MFI financial viability and growth, and its training staff need to be taught a new curriculum in order to deliver such training to MFIs.

Estimates place the average microenterprise failure rate at 80 percent per year, due mostly to lack of administration, pricing, marketing, and other basic business skills. USAID/M found that many microentrepreneurs see training and technical assistance just as important as credit. Such training and technical assistance is also critical to insure that credit extended through our partner MFIs is productively used, and that microenterprise borrowers can repay their loans.

In spite of clear need, a paying market for microenterprise training or technical assistance is not yet in evidence. Therefore, would-be service providers will require subsidies in order to cover their costs. The reasons for which training and technical assistance for microenterprises have not developed in Mexico may be several: donors have tended to focus on credit, rather than on other microenterprise needs; business training and technical assistance currently available in Mexico is geared to small, medium, and large enterprises, and is not appropriate for microenterprises; the body of world literature on microenterprises needs tends to focus on the poorest of the poor, rather than on microentrepreneurs operating between the poorest-of-the-poor and small business levels, whose businesses and needs are quite different; and there is no systematized, useful body of knowledge about microentrepreneur training and technical assistance needs in Mexico.

The Mission will observe and encourage the dissemination of results of the few pilot training and technical assistance programs currently operating, such as the IDB's projects in the University of Chihuahua Business School and in Tijuana, and the Swiss Government's experimental training program supported through FUNDES in the Iberoamericana University's Business School. However, USAID/M will not fund directly the development of microenterprise training or technical assistance programs under this strategy due to concerns regarding the current inability of such programs to recover costs.

Intermediate Result No. 3: Understanding of the role of microenterprises in the Mexican economy, in addition to understanding of the needs of microentrepreneurs and how these needs influence individual business and migration decisions, increased.

The Mission and its partners have identified a number of areas where in-depth research is needed to inform program design and policy dialogue, which are listed below as Sub-Intermediate Results. While some MFIs have gathered their own data about their microenterprise borrowers, this clientele is predominantly at the poorest-of-the-poor or subsistence level. No data exists on microentrepreneurs operating productive enterprises above this level.

Sub-IR 3.1: Study of microentrepreneurs needs, priorities, and subsistence level completed.

Sub-IR 3.2: Relationship analyzed between microenterprise ownership, employment and/or income, and the perceived need to migrate.

Performance Measurement Indicators:

a. Study of microenterprise needs completed and followed by second-phase study of relationship between microenterprises and migration in areas of high out-migration.

b. Based on study findings, policy dialogue opened with GOM, other donors, NGOs, MFIs, and appropriate USAID/M offices concerning future targeting of microenterprise resources.

A sensitive issue in both the U.S. and Mexican presidential campaigns is the rising rate of Mexican migration to the United States. Current data on migration is scant and poorly analyzed. However, anecdotal evidence suggests that lack of economic opportunities have increased people's perceived need to migrate in search of jobs and income. Conventional wisdom says that most Mexican migration to the U.S. originates in poor southern states such as Chiapas and Oaxaca. But more recent information suggests that Mexico's middle states of Michoacan and Jalisco may be the largest expulsion zones for U.S.-bound migrants. The origins of greatest migration flows need to be ascertained. Duke University research in Jalisco suggests a causal relationship between economic opportunities for microenterprises and the decision of low-income people to migrate. These findings need to be tested elsewhere and tied more closely to specific microenterprise opportunities. Results of this multi-phase study will enable USAID/M to determine whether microenterprise resources could be re-targeted to selected regions to help reduce the perceived need for migration, especially to the U.S.

<u>Sub-IR 3.3</u>: Information base developed to educate GOM policymakers, private enterprises, and public opinion-makers on the contribution of microenterprises to Mexico's economic growth, and to evaluate the potential for integration of microenterprises into the formal, mainstream economy.

Performance Measurement Indicators:

a. Study completed regarding actual and potential microenterprise contribution to Mexico's economic growth and potential microenterprise linkages with the formal economy.

b. Results disseminated and discussed with key GOM and other donor decision-makers.

Except for a 1996 survey of microenterprises in 10 urban areas carried out by the Mexican National Statistics Institute (INEGI), no reliable or useful data exists concerning microenterprises in Mexico. Because they lack any real knowledge of the sector, GOM policymakers tend to regard microenterprises as a temporary phenomenon that will disappear, along with the informal economy, as the formal economy grows and generates more salaried employment. Government policy toward microenterprise ranges from indifference to opposition, with the opposition due in part to the complaints of store owners that microentrepreneurs are street peddlers who take trade away from their businesses. The government directs significant amounts of public funds, including money received from MDBs, to promote the growth of small, medium, and large business. If a solid, fact-based case were made, it should be possible to educate GOM policymakers that the microenterprise sector is not merely composed of street peddlers, and that there is a significant band of productive economic activity at the micro level that is making an important contribution to the national economy. It would be desirable to convince the GOM that, with the proper support, microenterprises have the potential to contribute even more to the economy and thus help microenterprises gain access to some of the GOM's resources set aside for business development. At a minimum, bridging the GOM's knowledge gap could help open the door to informed policy discussions in the future regarding the need to improve the financial regulatory and supervisory framework for promoting microenterprise growth.

Intermediate Result No. 4: Models and mechanisms developed to meet the financial needs of rural microenterprises.

Sub-IR 4.1: Institutions identified and/or mechanisms developed to provide financial services to microenterprises in selected rural areas.

Performance Measurement Indicators:

a. Survey of microenterprise service providers in rural areas completed, and findings used to identify institutions able, with some assistance, to expand their service outreach to rural microenterprise customers.
b. In-depth, empirical assessment of rural microenterprise needs conducted in select USAID/M, other donor, and NGO project areas.
c. Mechanisms developed and tested for delivering microenterprise financial services tailored to conditions in selected rural areas.

While urban areas offer few resources for microenterprises, rural areas offer virtually none. To become self-sustaining, microenterprises supported by USAID/M in rural environmentally protected areas need financial and related services from an institutional service base that does not yet exist. Program partners identified the lack of knowledge about the needs of rural microenterprises, in addition to the deficiency of appropriate methods of responding to these needs, as a critical gap that is not being addressed. USAID/M will work in its own environmental project areas to design and test mechanisms for delivering these services to rural microenterprises.

To the maximum extent possible, USAID/M will use the experience of other donors and NGOs to refine its approach to rural microenterprise finance mechanisms. Examples of these experiences include the following programs:

- The World Bank's $15 million pilot Marginal Areas project will provide integrated rural development in 23 extremely isolated areas characterized by predominantly indigenous populations. The sub-projects will emphasize conservation and restoration of the environment, and will create microenterprises as alternative income sources. The Bank is open to the idea of installing a Marginal Areas sub-project in or near one of USAID/M's protected areas, which would provide an opportunity for close-range observation of this model. USAID/M will also benefit from lessons learned under all of the Bank's Marginal Areas sub-projects in the country.
- The Mexican Nature Conservation Fund (FMCN) wants to fund feasibility studies and business plans for new rural microenterprises. FMCN's experiences will contribute to USAID/M's knowledge of ways in which to support environmentally related rural microenterprise start-ups.
- The U.S. NGO The Nature Conservancy (TNC) has announced plans to create a new fund for environmentally related microenterprise projects in Mexico. USAID/M and TNC will collaborate in developing and testing rural microenterprise service delivery mechanisms.

- A consortium of environmental NGOs called ECOSOLAR is organizing a multi-NGO project called "Bioplaneta", which will provide a working model of methods of supporting environmentally sound, export-oriented rural microenterprises.
- The Inter-American Foundation (IAF) funds very small, rural microenterprise projects (e.g., eco-tourism) in poor, isolated areas. IAF's activities will provide USAID/M with additional information on ways in which to establish and maintain service-delivery mechanisms.

Although no institutional base of rural microenterprise services currently exists, a one-time survey conducted in 1998 by the IDB suggests that there may be numerous small, local organizations — most likely NGO and community-based groups — which, with the appropriate support, might be able to form the beginnings of an institutional service base for rural microenterprise. The Ford Foundation wishes to collaborate with USAID/M and Mexican partners to update the inventory of local organizations. The World Bank is also developing an inventory of local institutional service capacity for its Marginal Areas project which, if the Bank and the GOM agree to share with others, could add to USAID/M's knowledge base.

I - D. Customers

Practitioners and donors generally conceptualize the microenterprise sector as being composed of three main groups. The first group consists of extremely small (poorest-of-the-poor or subsistence level) enterprises, most of which are owned by women, who receive very small loans through solidarity, community, or other types of affinity groups, provided mostly through NGOs. Their businesses are mostly sales or service ventures operated from homes or on the street. Various models for supporting this group of customers have been successful both around the world and in Mexico in directing resources to the poorest of the poor. However, the subsistence level of microenterprises tends to be limited in capacity to grow beyond the individual entrepreneur stage, or to create jobs and income beyond the family unit. The second group of entrepreneurs has typically outgrown the subsistence stage, started to accumulate fixed assets, and begun to generate employment for non-family members. The third group is comprised of microenterprises which have started to expand their operations, generated new employment, are growth oriented, and demonstrate the potential for productive linkages with the formal economy. NGOs and MFIs in Mexico will continue to serve the poorest of the poor. However, the latter two groups — constituting an estimated two-thirds of microenterprises in Mexico — are receiving no services from any source. This segment of Mexico's microenterprise-related economic activity is believed to have the greatest capacity to generate income and new jobs for low-income people, particularly by forging business relationships with small and medium enterprises in the formal economy.

Under this strategy, USAID/M's customers will be MFIs with the ability and willingness to expand services to the un-served top two "tiers" of Mexico's microenterprise population.

In working with microenterprises, people often use such definitions as loan size to delineate the group they wish to serve. This criteria does not seem particularly useful for the Mexico strategy, in view of: (1) the extremely wide range of definitions and size criteria for microenterprises, which makes the choice of just one designation arbitrary;[4] (2) the wide range of

[4] USAID/M counted 12 distinct definitions of "microenterprise" used around the world, including four in Mexico alone.

microenterprises, all of which eventually need to be served by USAID/M's MFI partners; and (3) the fact that no USAID/M funds will be used for credit under this strategy. Therefore, the strategy will not impose loan size or asset ceiling restrictions as conditions for receiving USAID/M assistance. USAID/M will use the definition of microenterprise which appears in the Agency's policy guidelines, and which is used by the various institutions participating in the strategy.

I-E. End of Strategy Results

At the end of the three-year life of this strategy, the following products or results are expected to be in place:

- A permanent working group of Mexican leaders in microenterprise financial services will be formed and leading a joint effort to create the supportive institutional and policy framework needed for microenterprise growth in Mexico.

- One or more new source(s) of capital will be available for access by MFIs to increase microenterprise lending to a more-diversified microenterprise clientele.

- The feasibility of enabling MFIs to either access an existing credit bureau or create a new credit bureau will be analyzed.

- Financial management staff and operating systems of partner Mexican MFIs will be strengthened, allowing these institutions to grow and expand services to more microenterprise customers, especially those above the subsistence level.

- The knowledge base will be expanded about Mexican microenterprises above the subsistence level through special research. The information gathered will be used to start a policy dialogue with the GOM and other donors, with the aim of increasing future support for microenterprise development.

- Models will be designed and tested for delivering financial services to make environmental and energy conservation-based microenterprises self-sustaining, particularly in poor, rural areas.

II. SUPPORT FOR INSTITUTION BUILDING

II-A Strengthening Microenterprise Finance Institutions

MFIs have a better opportunity to realize their performance targets and achieve self-sufficiency and sustainability if they operate in the proper enabling environment, i.e., within a framework supportive of growth based on well-established and transparent legal requirements, regulatory and supervisory norms, and government policy.

In Mexico, the number of financially viable MFIs is extremely small (no more than 10), as is the number of customers they claim to reach (less than 100,000). These numbers are especially striking when contrasted with potential demand for microenterprise services in Mexico, as indicated by the country's production potential, numbers of people in the economically active population, lack of jobs in the formal economy, 30 percent or more growth rate of the microenterprise-dominated informal economy since 1995, and the fact that nearly one-half of Mexico's 100 population is estimated to be living under the poverty line.

USAID/M has concluded, therefore, that microenterprise growth in Mexico cannot reach the necessary levels to improve the economic well-being of the poor unless the institutional base for delivering financial services to microenterprises is present and functioning effectively. This strategy focuses on creating and strengthening that institutional base.

The following criteria were utilized in selecting Mexican partner institutions to participate in this strategy: (1) they represent or can serve the interests of a broad range of microentrepreneurs; (2) their type of operation contributes directly to strategy objectives; (3) they can receive and make effective use of USAID/M assistance; (4) they demonstrate commitment to the strategy objectives; and (5) they appear to be financially viable. The number of USAID/M partner institutions will remain small, partly because there are so few viable organizations operating, and partly so that the relatively small amount of USAID/M support may be concentrated for greatest impact. The Mission expects to focus its support and resources on a pilot group of MFIs, which includes: Credito Familiar, FinComun, ADMIC Nacional, and Grupo Progreso.[5] COLCAMI may become a partner for purposes of developing a new MFI financial management training curriculum. The Mexican NGO Pro-Desarrollo presently provides coordination and technical support to most of the partner MFIs. It is likely that the partners will select Pro-Desarrollo to coordinate their participation in the strategy.

USAID/M will support Pro-Desarrollo's coordinating role by helping the institution carry out a profile of its MFI members. The study's primary objective will be to understand the conditions

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[5] Other financial intermediary institutions that may also participate in the strategy at some future point include: Mexico City-based NGO Compartamos; The Santa Fe de Guanajuato Savings and Microcredit Institution in Leon; the Microenterprise Assistance Center (CAME) in Mexico City's Valle del Chalco; the Mexican Association of Social Sector Credit Unions (AMUCSS), the Association of Savings and Credit Societies (AMSAP); the Foundation for Rural Development; and perhaps one or two *Cajas Populares* yet to be identified. None of these institutions was judged to meet viability and/or other criteria for participation in the strategy at this time, although they could become partners if their individual circumstances change.

in which these MFIs operate. The study will assess financial and non-financial methodologies, examine the products offered as well as the application of these products, address the levels of sophistication of management information systems (MIS) utilized, and assess management styles. The study will allow Pro-Desarrollo to understand each member's competencies better, provide useful orientation, and develop programs that will support the growth of the MFI industry. Further, this profile will assist USAID/M in targeting its assistance in carrying out the strategy.

A critical constraint to increased microenterprise lending is the lack of capital in the entire financial system. With the exception of Credito Familiar, commercial banks have no mechanisms for microenterprise lending, and USAID/M's efforts to interest commercial banks in microenterprise lending have not succeeded. One of USAID/M's key contributions under this strategy will be the identification of one or more sustainable sources of new capital for MFIs. As one possible solution to the capitalization problem, USAID/M will explore means of accessing savings deposits held by partner MFIs. FinComun, for example, has about $7 million on deposit that could be lent to microenterprise. FinComun needs technical assistance and training, as described further on, to enable them to release and manage these funds for microenterprise loans. A DCA guarantee could be used to allow FinComun or other MFIs to access savings for lending purposes without putting at risk depositors' funds. USAID/M estimates that at least $500,000 in guarantees will be needed in FY '00 and another $1 million in guarantees will be needed in FY '01. The Mission will submit a formal request for guarantee support under the Agency's DCA program. As required under the DCA program, USAID/M would put up 10 percent of the guarantee amount from its own funds. In FY '00, the necessary $50,000 in Mission funds would come from strategy funding. In FY '01, the 10 percent Mission cash contribution would come from DA funds earmarked to start credit flowing to microenterprises under Mission environmental projects.

Another possible source of capital is PAHNAL, a public entity that captures small savings from thousands of depositors. PAHNAL has on the order of $160 million in small depositor savings, most of which is invested in Mexican Government Treasury notes ("Cetes") currently yielding about 16 percent annually. PAHNAL would like to invest as much as $40 million in microenterprises, but requires that the money be moved through triple-A rated Mexican banks, of which there are only three. PAHNAL could be requested to allow some percentage of their funds not invested through Triple-A rated banks to be lent to the partner MFIs for use in on-lending to microenterprises. USAID/M has held initial discussion with PAHNAL about this possibility, and will continue to address this opportunity during implementation of the strategy.

II-B MFI Management

A second major constraint to increased microenterprise lending is lack of adequate financial management capability within MFIs. Productivity per employee is substantially below the standard for microenterprise finance in other parts of the world. USAID/M's MFI partners under the strategy need varying degrees of institutional strengthening. Technical assistance and training will be individually designed for MFIs based on in-depth institutional needs assessments completed during the preparation of this strategy and on more in-depth institution-specific analyses to be carried out with technical assistance during strategy implementation. On-the-job and formal training will be provided for MFI financial staff and management to enable them to operate according to accepted microenterprise finance best practices. Technical assistance will be provided to partner MFIs to help them develop cost-effective working procedures and policies for financial management, accounting, inventory control, personnel management, asset and liability and savings management. Technical advice will also be provided to the MFIs regarding methods of increasing employee productivity and lowering operating and transaction costs as their clientele grows and becomes more diversified. Assistance will be provided to develop cost-effective internal information systems, to enable more rapid, accurate tracking of loans, and more flexible control over the organizations' financial status. Increasing internal efficiency and productivity through these measures should enable the partner MFIs to increase their microenterprise customer base and generate enough loan volume to become self-sustaining and independent of donor capital.[6]

II-C Support of Mexican Initiatives

In order to provide high-quality training in financial management to partner MFIs, the strategy includes technical assistance to COLCAMI, which operates as a separate business unit within the University Anahuac del Sur in Mexico City. COLCAMI appears to be the only training institution in Mexico that offers any type of microenterprise-related financial management training. It was started two years ago with $2 million in seed capital from the IDB, which created COLCAMI as a regional Latin American training institution. COLCAMI was intended to be self-sufficient within two to three years according to the IDB plan. However, COLCAMI has not achieved financial self-sufficiency, partly because it does not effectively market its services, and partly because the fees it must charge in order to cover its costs are beyond the financial means of most MFIs and other potential customers. COLCAMI has approached the IDB, USAID/M, and other donors, seeking subsidies to offer their courses throughout Latin America; for the foreseeable future it appears that the IDB will continue to provide budgetary support for COLCAMI.

USAID/M will also consider using a private consulting firm in Mexico City, Consultants on Financial Training and Development (CADEF), to provide some financial management training to partner MFIs. The director of CADEF formerly ran a financial management training school for the commercial banking sector, which closed when commercial banks could no longer support CADEF services after the 1995 peso crisis. CADEF would not be an optimum source of training given that the firm's experience is in commercial, rather than microenterprise, banking. Their curriculum would have to be modified to suit the needs of MFIs. Additionally, USAID/M is interested in creating long-term self-sustaining institutions, a status that consulting firms are less likely to achieve. USAID/M will also examine whether the business/financial management training program offered by the Technological Institute of Monterrey (ITESM) could be modified to meet MFI needs. ITESM is an excellent university with branch campuses located

[6] U.S. NGOs such as ACCION International and FINCA have provided technical assistance and training to Mexican NGOs functioning as MFIs, and will continue to do so under this strategy. ADMIC Nacional contracted ACCION technical assistance at its own expense during CY '99 to improve its management systems. However, the assistance focused on lending to the poorest of the poor through community or solidarity groups. This type of financial management is not appropriate for MFIs conducting individual lending to microentrepreneurs above the subsistence level.

throughout Mexico. Its quality and outreach make it a good candidate to become a MFI training center, if its course structure were modified for microenterprise finance managers and staff. Until a reliable, effective source for MFI financial management training can be developed under the strategy, training will have to be provided to the partner MFIs by the Long-term Technical Advisor/Program Manager who will be recruited to implement the strategy, in addition to periodic, short-term technical assistance.

II-D Rural Microenterprise

The Mission cannot meet its approved SOs in environmental and energy conversation, nor can it meet Agency Global Climate Change (GCC) objectives, without achieving large-scale replication, at the national level, of its tested methodologies for natural resource protection and energy conservation. In order for these models to be replicated broadly, they must be made self-sustaining over the long term.

The Mission has created microenterprises that produce such products as honey and natural cosmetics in its protected areas in order to help people stay on the land in ecologically fragile areas without destroying the natural resource base. In energy, the Mission has developed models for using energy-efficient and renewable energy technologies in micro and small enterprises. However, the technologies cannot be replicated on a large scale due to a lack of capital available for financing the costs of adopting such technologies.[7]

Despite the clear need and potential market demand, USAID/M was unable to identify any institutions – public or private – providing effective credit, training, or technical assistance to rural microenterprises. The GOM's Economic Development Ministry, SEDESOL, and Industrial Promotion Ministry, SECOFI, support microenterprise development projects in rural areas. However, complaints are often heard that design of these projects is done from the top down without consulting the intended beneficiaries, the selection of beneficiaries is not a transparent, needs-based process, and the results are very uneven. The GOM's Rural Development Bank (BANRURAL) has no operating rural offices and no money to lend. Although a number of very small NGOs are providing services to local rural groups and communities, none appears to have the capability of providing financial (and/or training and technical assistance) services on a large scale or over the long term.

The Mission's conclusion at this time is that there is no existing, effective model for institutional delivery of credit or other services to rural microenterprise in Mexico. The Mission's partner institutions confirmed that the absence of any support services for microenterprises in rural areas is a major gap that needs attention. They indicated that USAID/M could make a significant contribution by leading the way in this area. Thus, USAID/M will work with Mexican partners to seek ways to remove roadblocks to rural microenterprise growth and develop viable models for brining financial and other support services to rural microenterprises. USAID/M would use its existing environmental and energy projects to test such mechanisms.

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[7] Lack of capital is also a major constraint to the adoption of clean-energy and energy-efficiency technologies in medium and large enterprises.

Along these lines, the Mission has identified specific project activities for support. On the "brown" (energy) side, blue crab aquaculture in the seaside village of Celestun[8] will receive assistance to become self-sustaining. Started in order to provide income alternatives to over-fishing in the area, the microenterprises involved in this industry will receive assistance to test the application of solar power to pumping the estuary water required for crab cultivation tanks. If successful, the aquaculture program and its technology will be turned over to the community. USAID/M will fund technical assistance to help identify appropriate sources of on-going financial and other services that the microenterprises will need to keep operating profitably without donor help.

The Mission has also focused on the issue of motor repair as part of its energy conservation activities. Motors repaired (rewound) using newer methods and equipment operate much more efficiently, thus reducing energy waste. The Mission has implemented pilot projects in Mexico City to demonstrate the cost-effectiveness of the new methods and equipment. However, motor rewinding is done in small mechanical shops throughout the country. To realize a significant impact on energy conservation from this new technology, the Mission needs to develop a delivery system for financial, technical assistance, and training services to mechanics in these types of microenterprises.

The Mission will provide technical assistance and funding to the Mexican National Chamber for the Transformation Industry (CANACINTRA)[9] for the design of a program to educate shop owners and managers on the benefits of using the new methods and equipment. CANACINTRA will train electric motor repair shop technicians on the proper methods, specifications, and use of equipment to repair motors. Those shops that meet U.S.-based International Electric Standards Association (IESA) standards will receive certification. CANACINTRA will provide its members with a list of shops where certified motor repairs can be made. CANACINTRA will also teach industrial plant managers the economic benefits of having electric motors repaired according to the manufacturers' specifications, at repair shops certified to meet IESA norms. Thus, certified, small motor-repair shops will have a newly informed market that will be willing to pay more for their improved services. The required upgrades in equipment for microenterprises may be financed through USAID/M's MFI partners. USAID/M will provide technical assistance to the partners to help them access this new market for microenterprise lending. The design, start-up, and equipment costs of demonstration will be funded under the Mission's on-going Renewable Energy program.[10]

The Mission has also implemented renewable energy demonstration pilot projects at cattle ranches in the Chihuahua dessert. At the height of the dry season, ranchers must truck in diesel fuel over long distances to run water pumps in this arid region. Solar panels tested in

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[8] Celestun is an important feeding area for pink flamingos.

[9] The 30,000-member CANACINTRA provides training, certification, and laboratory services.

[10] Most of the market education, technical training, certification, and information services of CANACINTRA will be fee-based and provided by NORMEX, a specialized institute that receives support from the German aid program (GTZ).

Chihuahua enabled cattle ranches to reduce costs of pumping water to feed cattle and to irrigate pasture grasses and plants of high nutritional value, rather than depend upon over-grazing methods. The Renewable Energy Program has already assisted the installation of solar panels at over 345 localities, thus demonstrating significant potential for replication. Although the investment in solar panels can be amortized by ranchers over two to four years, the Mission has not been able to locate a reliable source of credit, which would motivate broad-scale adoption.

USAID/M plans to work with the Agriculture Ministry's Rural Development Fund (FIRCO) to mobilize the credit resources of the World Bank's Global Environmental Facility (GEF) for use in the Chihuahua pilot program. This approach to finding funding may not be truly sustainable over the long-term; however, the absence of any other credit resources from the commercial banking sector make it necessary to take such an interim measure. To help develop other, non-subsidized sources of credit for the future, the microenterprise strategy calls for work with partner MFI Grupo Progreso, a credit union in Chihuahua. With some technical assistance, Grupo Progreso will be able to provide credit so that suppliers of solar panels can help clients purchase this equipment. These small businesses will use the solar equipment as removable collateral, thus eliminating a financial barrier to growth of energy-related microenterprises.

The Mission's Renewable Energy Program will continue to support the promotion of solar energy and the technical training of vendors, firm technicians, and cattle ranchers, in addition to working with Grupo Progreso to prepare the latter to handle the technical aspects of financing solar energy installations.

On the "green" side, the microenterprise strategy will provide training and technical assistance to help make embryonic microenterprise programs in rural communities self-sustaining. Mexican NGO Pronatura has initiated an organic honey microenterprise involving five percent of the 20,000 persons living in and around the Kalakmul Nature Reserve. Pronatura is also beginning a backyard animal husbandry program and has plans to introduce a fruit tree and forestry management program.

USAID/M will use its own and other existing environmentally related microenterprise ventures to test models for institutional delivery of necessary support services. To get started, the Mission will work with its current MFI partners to open new programs or "windows" of credit for USAID/M-supported environmental and energy-related microenterprise. Technical assistance will be provided to the MFIs to help them move into this lending area. Mechanisms will be developed to meet the specific needs of the USAID/M-supported microenterprises, with the additional objective of identifying lessons learned that can be translated into a generalized model of service delivery for rural microenterprises.

Other donor projects will provide USAID/M with additional valuable information and lessons learned to refine its own delivery system models. The World Bank's experimental Marginal Areas project was recently expanded from five to 23 areas, and from $5 million to $15 million dollars. Carried out with the GOM's Agriculture Ministry (SAGAR), this project will create comprehensive integrated rural development programs for indigenous peoples living in extremely isolated rural areas. The Bank's integrated rural development concept includes teaching environmentally sound agricultural practices, in addition to creating microenterprises as an income alternative, to help reduce destructive land-use patterns. The Bank is interested in discussing with USAID/M the possibility of placing a Marginal Areas sub-project in or near one of USAID/M's existing protected areas project sites, most likely in a poor southern state such as Chiapas, Oaxaca, or the Yucatan. Thus, the Mission will leverage other donor resources to test additional approaches to sustainable rural microenterprise development under the strategy.

Another interesting model to be tested is a project called "Bioplaneta", which is being organized by a consortium of Mexican environmental NGOs headed by ECOSOLAR. The purpose of the project is to create sustainable, export-oriented microenterprises (e.g., natural cosmetics and eco-tourism) in poor rural areas by providing an array of financial, technical, and training services through member NGOs. The Mission sees Bioplaneta as another mechanism for designing and testing models for delivery of rural microenterprise support services. In return for exchanging information and providing USAID/M with access to the project's lessons learned, the Mission may offer Bioplaneta technical assistance under the microenterprise strategy to set up their financial management system for microenterprise credit or help them access capital through other funds.

Other potential partners in the testing of models include the Mexican Natural Resources Conservation Fund (FMCN), which is interested in using some of its $45 million endowment to help environmentally oriented microenterprises conduct feasibility studies and business plans to attract capital for start-up ventures. The FMCN activity could provide the Mission with a useful model for servicing start-ups of rural microenterprise. The Nature Conservancy (TNC) is planning to start a fund specifically for environmentally related microenterprises. The Mission needs to obtain more information to determine the possibility of partnering with TNC on testing rural microenterprise service delivery. Also, the IAF operates a number of rural, small microenterprise projects in various parts of Mexico.[11] Although the IAF is not able to enter into direct collaboration with donors, USAID/M and IAF already share information informally and it thus should be easy to incorporate IAF's lessons learned into USAID/M's rural microenterprise delivery models. Obviously, this list does not exhaust all the possible combinations of rural microenterprise service-delivery mechanisms. However, with the sector being essentially un-served at present, this list of interventions is a good start in the opinion of the Mission.

An important complement to the testing of delivery models will be a USAID/M-Ford Foundation collaboration to update the inventory of microenterprise service organizations in rural areas. This activity is described in the section which follows.

The results of USAID/M's research and testing will be disseminated to other interested institutions in Mexico, in addition to policymakers, in order to start the process of improving financial and other services made available to rural microentrepreneurs

II-E Filling Critical Knowledge Gaps.

[11] One interesting characteristic of IAF's operations in Mexico is the fact that they have managed to secure some modest financial backing from large Mexican businesses. Convincing big business to help support microenterprise growth is a long-term interest of the Mission and will be pursued as the opportunity presents itself.

With the exceptions of a 1996 survey of microenterprises in 10 selected urban areas conducted by the National Statistics Institute (INEGI), several small studies carried out by the Iberoamericana University in Mexico City funded by the Ford Foundation, and other small microenterprise studies completed in the northern border area by the Colegio de la Frontera del Norte prior to 1995, there exists virtually no information regarding Mexican microenterprises. USAID/M has been able to locate no reliable data on the needs of microenterprises or their role in the Mexican economy.

A number of NGOs which make loans to the lowest stratum of microentrepreneurs (e.g., COMPARTAMOS, CAME, and Santa Fe de Guanajuato) keep records of their clients' loan requests and repayments. Moreover, field workers (*promotores* or *asesores*) for these organizations know their solidarity or community group clients well. However, this data has not been collected or evaluated in an organized or standardized method from organization to organization, and it does not apply to the levels of microenterprise activity above the subsistence level.

To fill critical knowledge gaps identified, USAID/M will provide assistance to conduct the following research:

1. Relationships between Microenterprise and Migration

This study will test the hypothesis suggested by other independent research that ownership of, or stable employment in, microenterprises can help reduce the perceived economic need to migrate, particularly to the United States. Results may provide a basis for refined targeting of future microenterprise resources to areas of high out-migration within Mexico. The research will be conducted by well-qualified Mexican institutions in collaboration with one another, such as the National Population Council (CONAPO), which maintains national demographic statistics, the Colegio de la Frontera del Norte (COLEF), and/or the Iberoamericana University. The first phase of the study will identify the areas of highest out-migration at the national level. The next phase will examine the perceived needs and priorities of microentrepreneurs and the ways in which these issues may relate to the decision to migrate. Microenterprise needs will be analyzed in selected areas identified as high out-migration sources, and will also incorporate on-the-ground experiential data from USAID/M's rural environmental and energy programs.

For example, the population near the Kalakmul National Reserve in the Yucatan is comprised of persons who migrated from other areas under a government relocation program, as a result of natural disasters and civil strife. Mexican NGO Pronatura is researching the causes and effects of internal migration through its USAID/M-funded community development programs in Kalakmul. Pronatura is interested in identifying means of reducing migration through the provision of alternative income-generation programs. Pronatura's data on migration, and conclusions on ways to reduce it through increased economic opportunities, will feed useful, on-the-ground information for the overall migration study.

Research will concentrate on the two upper levels of the microenterprise spectrum, rather than the poorest of the poor, as explained elsewhere (see also the analysis in Annex 1: Profile of the Microenterprise Sector). The results of the study will serve as baseline data for USAID/M's MFI partners, so they can develop services and programs tailored to actual microenterprise needs and demands. This phase of the study will incorporate experiences and findings from other programs, such as the IDB's model programs in micro and small enterprise training in Chihuahua and Tijuana, and the Iberoamericana University's microenterprise training project. USAID/M will work with the implementing agencies and universities in developing the scope of work and implementation methodologies to ensure that the study produces pragmatic, useable results for MFIs.

These analyses will give the Mission the information base needed to determine the extent to which microfinance best practices could be applied or modified to meet the requirements of microenterprises and to identify and help develop the mechanisms required to make credit or other financial services readily available to microenterprises.

2. Rural Microenterprise Service Institutions

The Ford Foundation is interested in collaborating with the Mission in developing an inventory of rural microenterprise service institutions. This study would produce a snapshot in time of the many very small organizations (mostly NGOs) which work in rural communities throughout Mexico. Several years ago, the IDB put out a public request for proposals, and in response received nearly 100 expressions of interest from small groups interested in delivering credit to rural microenterprises. The IDB identified only four or five organizations among this group with the potential to serve a broader client base. The IDB's work may serve as a starting point for creating an updated list of organizations with the potential to develop the capacity to deliver microenterprise services in rural areas. Ford would fund this survey, with USAID/M technical participation.

3. Importance of Microenterprise

This study will help identify the contribution of microenterprises to economic growth and employment in Mexico. The potential for linking microenterprises to the mainstream economy will also be studied (e.g., possibilities for microenterprises to be suppliers to small and medium enterprises). The results of the study will be used by USAID/M and its partners to provide reality-based information to GOM policymakers, and start an informed dialogue on future public assistance for microenterprise support institutions.

II-F Other Institution-Building Initiatives

The strategy also includes several efforts to assist MFIs to improve inter-institutional collaboration practices required to improve industry-level performance. One effort will be to analyze either linking MFI partners to an existing credit bureau or assisting them in establishing a new credit bureau. Additionally, the strategy will assist MFI partners understand better and begin to adopt a system of self-regulation.

(1) Credit Bureau

Credit bureaus are a relatively new concept in Mexico. After the peso crisis of 1995, the large commercial banks established a credit bureau for their own use, in association with one of the three largest U.S. credit reference bureaus, Trans Union. This credit bureau, in addition to several others recently opened, provides credit references to commercial banks and a few other large creditors, such as department store chains and credit card companies.

Trans Union de Mexico is not used widely by USAID/M's partner MFIs given that this credit bureau caters only to large institutions and provides information on large corporate clients and upscale consumers. Access to Trans Union information is also very expensive, and it does not hold useful information on the average rural or microentrepreneur client. One partner MFI found that only about 30 percent of its microenterprise loan applicants in Mexico City are even listed by the bankers' credit bureau, and for such applicants only a small percentage of files holds any useful information.

MFIs in Mexico believe that a credit bureau would enable them to develop the industry by relying more on the applicant's character and credit history than on collateral, salary, ability to pay, and other standard criteria which microenterprises often cannot meet.[12]

Credit bureaus are particularly useful for organizations managing a large number of very small loans, as is the case with microenterprise lending. When MFIs and other creditors factor credit references into their decision-making processes, portfolios tend to experience an increase in profitability as lending can be targeted to more trustworthy borrowers. This practice reduces MFI transaction costs in managing and collecting on small loan portfolios. Just as important, using a credit bureau should help improve loan repayment rates because borrowers develop more timely repayment habits when they know that their performance is being tracked and shared by creditors. This would be particularly useful in Mexico, where a long-time pattern of public-sector lending without expectation of repayment has created a no-pay entitlement culture that causes difficulties for MFIs. In addition, good credit histories enable borrowers to diversify and increase their credit options, particularly when they move from one location to another, or outgrow the amount of credit their current provider is able to offer. Thus, access to credit by microentrepreneurs could be increased, particularly in rural areas, when MFIs have access to a credit bureau serving their particular needs and market.[13]

Because Mexican regulations require that credit bureaus share information, microentrepreneurs' credit histories could be made available to credit bureaus serving the commercial banks. This could bring microentrepreneurs another step closer to accessing commercial credit in the future.

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[12] In Bolivia, a similar solution is being sought due to the failure of both the Chamber of Commerce's credit bureau and the Superintendence of Bank's risk control program to help weed out bad credit risk individuals who borrow from several MFIs at the same time, and the resultant rise in delinquency rates. In late 1998, USAID/Philippines analyzed the client accounts at two of three bank branches in one rural town. One branch had been in operation for 25 years (and presumably knew the local clientele well), while the other had been in operation for only 12 months. Analysis showed that approximately 20 percent of new loan clients at the new bank branch had past-due accounts at the long-established bank, and half of these clients had already become past due at the new bank. For similar reasons, USAID/El Salvador is assisting seven NGOs under its Microenterprise Initiatives Project to establish a credit bureau which will provide credit history and references to MFIs.

[13] A study conducted under USAID/Honduras' PRODEPAH program determined that 80,000 rural borrowers could not gain access to commercial or business financing credit, in spite of having sufficient income and collateral, because they lacked a formal credit history which potential lenders could evaluate.

Although most MFI partners are small organizations, Pro-Desarrollo members led by FinComun, as well as a mass lender Financiera Independencia, are interested in both analyzing the possibility of joining an exiting credit bureau or launching a new bureau. MFIs are willing to invest their own funds to follow up on whatever option proves to be more appropriate. USAID/M will provide technical assistance to Pro-Desarrollo so that it may carry out this analysis on behalf of its MFI members. The study will include a cost-benefit analysis for participating institutions and provide MFIs with a realistic picture of the level of effort and of commitment required for either option. USAID/M will also help Pro-Desarrollo organize workshops for its MFI members to address in more detail the benefits of joining or creating a credit bureau and sharing information on credit customers. Further, USAID/M will explore options for collaboration with the LAC Bureau's new Regional Microenterprise project in carrying out this effort.

(2) A System of Self-regulation

Best financial practices are based upon sound administration of the following operations: financial reporting and monitoring systems, portfolio management, risk assessment, product packaging and pricing, debt management, and business planning. The purpose of prudential regulation and supervision is to ensure that these practices, in addition to the underlying systems and procedures that support them, are institutionalized. In the absence of external supervision and regulation, inadequate accounting, audit, management, and information systems may threaten the long-term viability of financial institutions.

The lack of such norms in Mexico has left the microenterprise finance sector in a weak position. MFIs are found operating either outside the inadequate existing regulatory framework or in an environment in which the supervisory authorities lack the capacity to function effectively. Without adequate regulation and supervision, MFIs are limited in their ability to market to new customers, or expand the financial products and services they offer, in order to grow. Therefore, the more MFIs operate in accordance with best-practice precepts, the more likely that commercial banks will extend credit to these entities. This will reduce the need for donor or government-subsidized funding and promote long-term sustainability of the institutions serving microenterprises.

As described in Annex 2, The Financial Sector, the Mexican financial system suffers from the inability of regulators to effectively supervise financial institutions. In addition, the GOM's regulatory authorities are concentrating first and foremost on supervising the commercial banks, whose financial health is fragile. While commercial banks can utilize risk-rating agencies, Mexico's MFIs are still in need of a system of self-regulation that can help them set, monitor, and control performance standards.

With the adoption of an agreed-upon system of self regulation, several microfinance institutions could join together on a voluntary basis and establish accounting, financial reporting, and financial performance standards similar to the CAMEL[14] model or any other model most

[14] CAMEL is a rating and grading system used by the financial sector to measure institutional and financial performance and risk, in addition to compliance with regulatory norms. A similar system was developed for microfinance institutions by Accion International. Other similar systems include the PERLAS system developed by

accepted by banks and risk-rating agencies in Mexico. With an effective performance-monitoring system in place, the participating institutions could analyze their own performance on a periodic basis and escape some of the restrictive laws which keep MFIs segregated into institutional segments.

Creating a functioning system of self-regulation for MFIs is at least a five-year undertaking. USAID/M cannot achieve this goal within a short, three-year strategic timeframe. However, our MFI partners are keenly aware that, if such a system is not created in the near future, lack of adequate supervision will hinder their growth. There has been informal debate among a few Pro-Desarrollo members regarding the best way in which to create — and have the government accept — a system of MFI self-regulation. However, because one organization's self-regulation is another organization's strangulation under Mexico's patchwork of financial laws, it has proved difficult to reach consensus within the MFI community as to which system to pursue or the way in which to adopt a selected system. USAID/M will take the opportunity to support this Mexican initiative with a small amount of technical advice to the Mexican Working Group, and through planned workshops regarding such topics as auto-supervision, deposit insurance, or information sharing, to help MFI partners sort through the complex issues which need to be resolved. If the MFIs succeed in achieving self-regulation, this should help expand microenterprise options for obtaining credit and financial services.

III. IMPLEMENTATION PLAN AND BUDGET

III-A Program Management Options and Mechanisms

USAID/M recognizes that Mission staffing and the budget for this strategy are very limited. However, implementation of this microenterprise strategy is critical to achieving two established SOs in addition to supporting the USG's policy for supporting economic growth in Mexico. A microenterprise institution-building strategy cannot be implemented solely for and within the environmental and energy SO programs for reasons explained elsewhere in this document. Therefore, the Mission has no choice but to go forward with this strategy, using the most practical means to do the job, and seeking support from other Agency partners. The Mission evaluated a range of strategy implementation mechanisms to identify the most efficient, least expensive, and least staff-intensive alternatives.

The Mission's first alternative is to take full advantage of all other management resources available. In order to cover effectively all elements of the Results Framework, USAID/M will:

(1) Leverage other donor financial and management resources. As previously noted, it is possible that one of the World Bank's Marginal Areas sub-project will be located in or

the World Council of Credit Unions, and the Format for Appraisal of Microfinance Institutions developed by the Consultative Group to Assist the Poorest.

near a USAID/M protected areas site. Additionally, various NGOs have planned microenterprise support programs to support the protection of sustainable land and energy use. USAID/M will draw on all of these resources, through information exchange and sharing of lessons learned, to modify and strengthen the design and testing of its own rural microenterprise models in the Mission's existing environmental project areas;

(2) Partner with the LAC Bureau through LAC/RSD's Regional Microenterprise program to receive high-quality technical assistance and guidance in creating key institutional support mechanisms for microenterprise growth;

(3) Partner with the Global Bureau to take advantage of their broad microenterprise expertise from many countries around the world;

(4) Work through existing USAID/M SOs. The Mission has highly qualified technical staff in charge of implementing the environment and energy SOs. These experts will help oversee that portion of the rural microenterprise strategy component to be implemented through USAID/M's existing environment and energy activities. This means USAID/M will also be able to avail itself of existing partner organizations under both SOs to carry out portions of the microenterprise strategy;

(5) Obtain credit guarantee resources under existing mechanisms. The Mission is seeking DCA or other guarantee authority in FY '00 and FY '01 to help access new capital for microenterprise lending in Mexico.

The Mission's second option to help lessen its management burden is to make maximum use of Mexican partners' capabilities. The level of sophistication and commitment of the Mission's Mexican (and other donor) partners permits USAID/M to rely more heavily on local implementing agents than other Missions possibly can. The Mission considered having Mexican partner organizations direct strategy implementation themselves, with USAID/M providing only short-term technical assistance (through IQCs, for example) for specific issues.

The Mission's partners are a sophisticated and dynamic group who will take a strong leadership role in defining the priorities and programs of the strategy. "Customer implementation" was an attractive idea from a strategic point of view, to reinforce the concept that the strategy belongs to, and is the responsibility of, the Mexican partners. But the fact is that if Mexican partner institutions were technically able to carry out this strategy without outside assistance they would have done so long ago. In addition, the partners are small organizations, fully engaged in their own day-to-day management operations, and they do not have time or extra staff to manage this strategy.

Since it appears likely that the Mission's partners will select the NGO Pro-Desarrollo (of which they are all members) to coordinate the MWG and organize their workshops, the Mission considered having Pro-Desarrollo serve as the principle program implementation director. The functions which Pro-Desarrollo would have to carry out are essentially the kind of organizational and coordinating work it already conducts. Further, managing the strategy's implementation would help create a stable base for long-term microenterprise sector support, after USAID/M assistance terminates. This option was discussed with Pro-Desarrollo and some of its members, but the following objections were raised. First, Pro-Desarrollo's management structure is very thin, consisting of only a director and one secretary. The responsibilities of strategy management would thus overwhelm the other functions staff carry out in support of members. Second, the partners are unwilling to have Pro-Desarrollo have a more directive relationship with its members. Pro-Desarrollo is very sensitive to the need to maintain its position of neutral support for its members, and does not want to go beyond its coordinating role at this time.

The Mission also considered the following additional options for transferring workload:

(1) Spinning off some strategy components to other donors.

Despite the possible benefits of this option, a major constraint exists in that the major donors demonstrating interest in the microenterprise sector — principally the World Bank and IDB — are required by Mexican law to work through public-sector institutions. The Mission's strategy is intended to work with and strengthen private-sector institutions because government programs are not appropriate vehicles for carrying out this work. Rather than lose control over the way in which the strategy would be directed, in addition to whom the strategy would be directed, the Mission felt it necessary to retain an active role in coordinating all strategy components.

(2) Use field support for program management.

USAID/M has made extensive use of the field support mechanism to obtain highly qualified technical and program management through the Global Bureau, for use in such areas as energy, bio-diversity protection, and HIV/AIDS. Global Bureau's wide array of technical expertise and resources in the microenterprise sector make this an especially attractive option. Having an institutional contractor or a U.S. NGO contracted via a Global Bureau program to take charge of implementation would relieve the Mission of implementation paperwork, such as arranging for short-term technical assistance. An institutional partner would also insure that both the Mission and its partners would have continuous access to top-quality technical talent. That said, much of the extremely limited budget for this strategy might make this option unpractical. In addition, some of the possible institutional partners promote just one model and methodology for microenterprise lending, which would prevent USAID/M from developing models tailored to individual situations.

Finally, the Mission reviewed possibilities for reducing the scope of the strategy. Although segments of the strategy are reasonably discrete, each component has been selected and designed to complement and reinforce one another in achieving each IR. If any part of the strategy concept were eliminated, the overall viability of the strategic objective would be impaired, as would the ability to achieve long-term, self-sustaining growth for microenterprises.

Given that the Mission lacks in-house staff for managing a microenterprise program, it will be necessary to obtain implementation services from some outside source. Mexico's microenterprise services sector is evolving in many different technical and policy directions at once, and the Mexican partner institutions will not participate in this strategy unless USAID/M provides the highest-quality technical assistance. The Mission's support for partner initiatives also needs to remain creative and flexible. Therefore, the Mission has decided to recruit a full-time, long-term technical advisor (LTA) to manage the microenterprise program. This technical expert will have a dual role: providing customary USAID project management services, while simultaneously providing the highest-quality day-to-day technical and strategic support for the partners' initiatives. The LTA would use his/her knowledge and contacts to identify specialized outside help, to which the Mexican partners do not have ready access. In addition to standard USAID management functions, the scope of work for the LTA would include the following responsibilities: help structure and oversee implementation of the major components of the strategy; provide support in strategic planning, training, and technical assistance for MFI and other microenterprise services providers; structure the design and testing of service delivery mechanisms, to make rural microenterprise sustainable under USAID/M's environment and energy programs; guide the planning for, and monitor implementation of, key research carried out by Mexican partner institutions; interface with other donors working in related areas to facilitate information sharing; and insure that the Mexican Working Group has ready access to high-quality technical advice in planning for the future of the microenterprise services sector. The LTA, in consultation with USAID/M, will also identify specific needs for which specialized short-term technical assistance will be required.

The Mission will advertise worldwide for the LTA, who will be recruited at the GS13 or 14 level, and may hire either a PSC or IQC contractor to fill the LTA position, depending on which option generates the individual with the best qualifications who is also available for duty immediately. The timeframe for this strategy is extremely short, therefore the Mission will seek, in particular, candidates with substantial field experience — preferably in Latin America or Mexico — to reduce the time required for the LTA to become familiarized with the program. If a PSC is hired, s/he will be based in the Mission to reinforce the concept of USAID/M neutrality in its dealings with partners. If a firm is awarded a contract via an IQC, the LTA will be required to procure office space outside the Mission. A PSC would receive administrative support from the Mission, while an IQC contractor would provide its own necessary administrative support.

III-B Timing of Implementation

The following Implementation Plan is illustrative. (See timeline implementation diagram attached to this document).

Approval of Strategy: Month 1, microenterprise strategy reviewed and approved by USAID/Washington. FY '00 Global Bureau Prime grant funds provided to serve as bridge funds for early implementation activities.

Hiring LTA: Scope of work drafted, sent to Regional Contracts Office (RCO) and Regional Controller in USAID/El Salvador for processing. Job announced for open, world-wide competition, and applications/proposals received by USAID/M, month 4. Applications/proposals evaluated; Mission Selection Committee interviews best-qualified candidates, makes selection, and signs contract, month 5. LTA on-board, month 6 or 7.

Early Implementation: While LTA selection is underway, Mexican Working Group (MWG) will be constituted, and will define the role of the coordinating organization, months 2-6. Research studies designed, scopes of work approved by USAID/M, and preparations made to start research work, months 2-6. Informal agreement will be reached with other donors on sharing of information and lessons learned, months 2-6.

Implementation of Sub-Intermediate Results, after arrival of LTA:

Implementation of Sub-IR 1.1: MWG approves detailed work plan, and individual members commit to carrying out identified activities, month 8. First observation trip organized and carried out for selected MFI members of MWG to learn about microenterprise finance best practices in other countries, month 9. First and second workshops on priority issues held, months 10-12. MWG identifies most important limitations and constraints to microenterprise growth, identifies priority issues, and establishes group objectives, months 13-14. Strategy work plan revised to reflect MWG agreements and plans, month 14. Second observation trip for MFI members of MWG, month 16.

Implementation of Sub-IR 2.1: LTA identifies short-term technical assistance to help MWG conduct pre-feasibility study for joining existing credit bureau or establishing new bureau, months 6-12.

Implementation of Sub-IR 2.2: LTA starts work with MFIs to gain access to new sources of capital for microenterprise lending, month 6. Short-term technical assistance used to support USAID/M request for DCA credit authority, months 7-9. DCA credit guarantee request reviewed and approved by USAID/Washington, months 9-12. During months 10-16, discussions held with PAHNAL about channeling funds through Triple-A rated Mexican bank(s) for microenterprise lending. Possible agreements executed to channel PAHNAL funds to other partner MFIs, months 16-36.

Implementation of Sub-IR 2.3: Based on the institutional needs assessments prepared for this strategy, LTA develops programs and schedule for providing financial management training and technical assistance to partner MFIs, months 7-11. LTA provides on-site financial management training to partner MFIs, according to schedule, supplemented by courses from Mexican training institutions, months 11-36. LTA develops SOWs to strengthen individual partner MFI operations and management, months 7-9. LTA monitors and provides follow-up technical assistance to partner MFIs on implementation of technical assistance recommendations, months 9-36.

Implementation of Sub-IRs 3.1, 3.2, 3.3: LTA assists partner institutions in developing scopes of work and implementation plans to conduct research studies, months 6-9. During months 9-21, two migration studies will be carried out, one to identify areas of high out-migration, and one to analyze migration in relation to microentrepreneur needs, with results being cross-correlated. Results of these studies will be used as basis for USAID/M decisions, and dialogue with other donors/GOM, about future microenterprise assistance targeting, months 21-27. Analysis of the actual and potential role of microenterprise in the Mexican economy carried out, months 12-18. Results broadly disseminated and used as basis for MWG policy dialogue with GOM concerning allocation of public resources to microenterprise promotion and/or strengthening the regulatory framework to provide an enabling environment for MSOs, months 17-36.

Implementation of Sub IR 4.1: Update survey of existing rural microenterprise financial, training, and technical assistance service providers conducted with Ford Foundation, months 9-13. In-depth study of rural and urban microentrepreneur needs and demands and relationship of such issues to migration decisions designed and carried out, months 13-15. Results of both studies used to develop and test mechanisms for delivering credit, training, and technical assistance to rural microenterprises, months 16-30. USAID/M environmental programs modified to reflect lessons learned, and plans developed for future development of microenterprise in support of USAID/M's environmental SOs, months 30-36.

An interim evaluation of all program components will take place after eighteen months to identify and correct, if necessary, any implementation or policy problems. Lessons learned from non-USAID/M activities will be incorporated, as they become available, into the appropriate components. A final evaluation is scheduled for the end of the three-year strategy.

III-C. Illustrative Budget

Annex No. 1

I. THE SOCIO-ECONOMIC ENVIRONMENT

At first glance, the Mexican economy appears to have recovered quickly from the "peso" crisis of 1995, averaging a real growth rate of 6 percent in 1996-97.[1] In large part the economic rebound resulted from the government's adherence to its economic reform strategy, the adoption of a floating exchange rate policy, and the decision to reduce public expenditure.

In late 1997, the economic global crisis began to affect the Mexican economy. Oil prices dropped an average of 36 percent during 1998, which in turn caused a drop in public revenues equivalent to approximately one percent of GDP. A rapid Government of Mexico (GOM) response compensated for the drop in revenues, although at the expense of long-term investment.

In 1998, inflation resumed its downward trend as the peso appreciated and nominal interest rates plummeted. Since that time international reserves have remained stable, the stock market, while highly variable, has risen, and the fiscal deficit for calendar year 1998 was on target; however, public debt has grown. The latter development is a cause for future concern, as the GOM absorbed as much as 60 percent of the bad loan portfolios of commercial banks in an effort to forestall a financial market collapse. This action has substantially reduced the GOM's ability to use public funds for economically productive investments. Most investment capital is now coming into Mexico from private external sources, as well as from through large-scale loans provided by multilateral development banks such as the Inter-American Development Bank (IDB) and the World Bank (WB).

Although less than half the 5.6 percent average GDP growth rate registered in the first three quarters of 1998, GDP growth in the fourth quarter of 1998 was 2.6 percent, thus exceeding expectations. This put GDP growth for the year at 4.8 percent, slightly above the revised government projection of 4.6 percent. All economic sectors registered positive growth, with transportation and communications representing the most dynamic activities by both recording annual growth rates of 10.1 percent. These sectors were followed by manufacturing, which expanded by 7.4 percent. In contrast, the agricultural sector maintained its stagnancy of recent years by expanding by a meager 0.5 percent.[2]

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[1]Real GDP growth (expressed as a percent, at 1993 prices) for the period 1994-1998 was: 4.5,-6.2, 5.2, 6.8, 4.8.

[2] Data obtained from the *Encuesta Nacional de Empleo*, National Institute of Statistics, Geography and Informatics (INEGI), 1997.

Economic activity slowed again in early 1999 in spite of the increase in the price of oil to approximately $15 a barrel.[3] This downturn has demonstrated that the apparent rebound of the previous has disproportionately benefited certain economic sectors and population groups. The International Monetary Fund recently reported that the Mexican economy is still vulnerable and the financial system is extremely weak and in need of reform. Mexican GDP is expected to decline to 3 percent in 1999, but is set to quickly recover in 2000, to a 5 percent annualized rate. The IMF also reports that recent economic reforms have increased the economy's resilience to economic instability, fiscal policy is tight, and social spending is on track.[4]

Mexican officials recently stated that the GOM had obtained $23.7 billion in international credits and refinancing to protect the country from economic shocks during the presidential election year (1999-2000). The package includes loans from the IMF, the U.S. and Canada, the World Bank, the IDB and the U.S. Export-Import Bank.[5] The IMF has provided a $14 billion stand-by letter-of-credit that will be drawn down in tranches only if economic conditions warrant emergency financing. All of these latter issues point to a relatively stable economic environment through 2000.

In the following sections we discuss some of the socioeconomic issues which will have a strong impact, be it direct or indirect, on the proposed USAID/Mexico strategic plan.

I-A Growth of the Informal Sector

A decade of economic reforms in Mexico has not resulted in a pattern of balanced and sustainable economic growth. Instead, a dual-track private sector economy has emerged. Grouped in a small band at the top of the economy are large, export-oriented enterprises,[6] while the majority of economic units are domestic small- and medium-sized enterprises (SMEs) and microenterprises focused primarily on the domestic market. The 1995 crisis is believed to have widened substantially the gap between these two groups, as indicated by estimates of rapid growth in the informal economy concurrent with massive, crisis-induced job losses. Desegregated economic data suggest that the gap continues to widen.

The International Labor Organization (ILO) estimated that the urban informal sector alone—defined as domestic workers, self-employed, and non-professional independent workers—increased from 24.7 percent in 1980 to 38.6 percent in 1994, just prior to the *peso* crash, which cost Mexico over one million salaried jobs and cut average buying power (real wages) by at least 40 percent. Although reliable statistics on the informal sector do not exist, the growth of the informal sector is estimated by measuring the increase in the number of employed persons

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[3] The average price of a barrel of oil during the first half of 1999 was $11.50, with recent oil prices languishing below $10. One of the lessons learned from recent economic experiences is the extent to which the GOM budget remains dependent on one highly variable commodity: oil. Furthermore, the affects of oil on the economy remain strong despite the fact that oil is no longer the country's main export. *IFR Latin America, Mexico,* August 1999.

[4] Yahoo! Finance, July 7, 1999.

[5] Ibid.

[6] Recent statistics show that about 80 percent of new jobs are generated by the export industry (i.e., *maquilas*), most of which are located in the north of the country.

not covered by the social security system. In Mexico, this level increased from 48 percent in 1988 to 55 percent in 1996.[7] The most recent survey by the Mexican Government National Institute of Statistics (INEGI) stated that of an economically active population of 35 million, 19 million, or 54 percent, operate in the informal sector and do not pay any type of taxes, aside from sales tax.[8] While this pattern may suggest that the labor market is not performing its resource allocation function efficiently, it confirms that the opportunities for faster growth and increased productivity based upon economies of scale, the introduction of new technologies, and increased investment in fixed capital are limited.[9]

Although up-to-date statistics are unavailable,[10] available data suggests that recent changes in the sectoral and job characteristics of the Mexican labor market are strongly correlated with informality. For example:

- In terms of occupational structure, the percentage of unremunerated family members as a portion of total employment rose from eight percent to 13 percent between 1980 and 1995, while the proportion of remunerated workers and employees declined from 63 percent to 57 percent during the same period.

- During the period from 1986 to 1993, the share of enterprises employing five or fewer employees increased from 33.6 percent to 38.3 percent, indicating that small businesses accounted for a larger share of newly created jobs than large businesses.

- With respect to sectoral composition, between 1979 and 1995 the proportion of people engaged in manufacturing declined from 20 percent to 15 percent, while the percentage of those engaged in services and commerce increased from 41 percent to 50 percent.

In discussing informality, the informal[11] economy and poverty should not be automatically considered as synonymous terms, given that labor market distortions have also contributed to the expansion of the informal sector. First, a large informal sector probably reflects the inability of the formal sector to absorb the growing pool of workers in sufficient numbers. Thus, for the foreseeable future, the informal sector clearly offers the best chance for many people seeking to earn a living. In this regard it is worth noting that the GOM reports that the average open unemployment rate between 1980 and 1997 was below 5 percent despite three major recessions. However, the Ministerial Counselor for Economic Affairs of the

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[7]Cited in *World Bank Country Economic Memorandum*, August 31, 1998, page 71.

[8]Cited in an article in *El Financiero*, February 12, 1999.

[9]A 1997 OECD Economic Survey of Mexico stated that "labor market problems in Mexico do not manifest themselves in high open unemployment rate (...), rather they revolve around the nature of employment: uneven access to job opportunities, an increasing share of low-productivity, low-paid jobs, employment conditions that often do not favor human capital development and do not provide social security insurance are all worrying features." Ibid, page 69.

[10]Source: "Mexico: Enhancing Factor Productivity Growth", World Bank, August 31, 1998. The informal sector can be defined in terms of social security coverage, firm size, and so forth. There is no generally accepted measurement technique. The ILO estimates include domestic, non-professional self-employed and independent workers.

[11] Informality usually refers to economic units not being registered with tax collection agencies, the social security system, or GOM government agencies which approve business operations.

U.S. Embassy in Mexico reports that the economically active population (EAP) is increasing by about 1,000,000 individuals per year, while the formal sector is only absorbing 70 percent of this quantity. Further, GOM data on employment is not very useful due to the fact that official statistics track only salaried employment at firms registered with the Ministry of Finance.

Second, several shifts in the incentive structure may encourage workers and firms to opt for informal work arrangements. Most importantly, non-wage labor costs (fiscal obligations including social security and health insurance contributions) have increased by 44 percent between 1983 and 1997, a burden which is routinely absorbed by workers in the form of lower take-home pay. Also, formal sector enterprises tend to rely upon overtime and part-time workers, rather than hiring additional employees. In combination, these two factors may in part account for a sizeable amount of informal sector expansion. Whatever the causes, when the net benefits, be they perceived or real, of working in the informal economy exceed those to be gained in the formal sector, a certain portion of the EAP may perceive informality as their best option for earning a living.

In this environment, the GOM perceives the informal sector—including microenterprises—as an issue that will disappear soon as the mainstream economy improves. Therefore, "informals" are watched with indifference, if not with hostility, and support in the form of training, technical assistance and capital is not readily available. This attitude is exacerbated by constraints faced by the IDB and the WB, in that multilateral banks must channel their resources through the GOM's national budget. These institutions have to support GOM agencies, which are in many cases ineffective or which focus solely on small- and medium-sized enterprises.

In addition, there is a troubled relationship between large private business and microenterprises. Research carried out by USAID/Mexico uncovered active hostility on the part of medium- and large-sized private businesses toward the microenterprise sector. Microenterprises are regarded as a threat, as they are considered to be by and large illegal street vendors who steal sidewalk space, take business away from legitimate (registered) merchants, and do not pay taxes. However, some outstanding exceptions exits. As an example, the President of Bimbo Bread actively invests in individual microenterprise projects (e.g., Invertir) and the President and Founder of Santa Fé de Guanajuato views the microenterprise sector as a potential future market for the sale of company goods.

I-B The Labor Market

The rate of population growth in Mexico has declined from 3.4 percent per annum in 1960 to 1.9 percent in 1997. At the same time, the growth of the EAP (persons aged 12 and older) remains very high, averaging 4.2 percent per annum during the 1993-1997 period. Also, the growth of the labor force is accelerating as Mexico's largest population group—those individuals under the age of 15—is starting to reach employment age. At present, the labor force is estimated to be growing by an annual average rate of around 3 percent, or 1.1 million persons, per year. Given a low rate of "open unemployment," one might assume that there has been an increase in jobs sufficient to absorb new entrants into the labor market. Table 1 presents basic data on the Mexican labor market.

Table 1: Mexican Labor Market

Labor Market[12]	1994 a	1995 a	1996 a	1997 a	1998 b	1999 c	2000 c	2001 c	2002 c	2003 c
Labor force (m)	35.4	36.5	37.5	38.5	39.5	40.5	41.6	42.7	43.8	45.0
Labor force (% change)	3.1	3.1	2.7	2.7	2.7	2.7	2.7	2.6	2.6	2.6
Employment (m)	34.1	34.2	35.7	37.0	38.2	38.7	39.6	40.1	40.8	41.2
Employment (% change)	2.7	0.4	4.4	3.7	3.2	1.2	2.3	1.4	1.6	1.0
Unemployment (m)	1.3	2.2	1.7	1.4	1.3	1.9	2.0	2.6	3.0	3.8
Unemployment (%)d	3.6	6.1	4.6	3.7	3.2	4.0	3.5	3.6	3.5	3.5

However, one must look beyond the official rate of "open unemployment," which only takes into consideration persons falling within the EAP category who actively sought salaried employment during the 3-4 week period prior to the period under review. As Table 2 suggests, the estimated unemployment rate since 1993 has exceeded 15 percent per annum, a figure which does not factor in the number of legal and illegal immigrants leaving Mexico.[13]

Table 2: Employment Data (all figures in '000)

Economically Active Population (1)	1993	1995	1996	1997
Total Population	86,613	90,164	92,159	93,938
Total EAP	33,652	35,558	36,581	38,345
Employed	28,246	29,216	30,700	32,337
Difference	5,406	6,342	5,881	6,008
% without work	16.0 %	17.8 %	16.07 %	15.67 %
Open Unemployment	819	1,677	1,355	985
Open Unemployment as % of EAP	3.4 %	6.3 %	5.5 %	4.1 %
EAP as % of total population	38.8 %	39.4 %	39.6 %	40.8 %
% population growth	1.84 %	1.77 %	1.73 %	1.72 %
% growth of the EAP	7.7 %	5.6 %	2.9 %	4.8 %

(1)EAP = the population 12 years of age or more employed in some type of economic activity (i.e., producing some type of good or service for the market or for self-consumption) during the period in question, as well as those who were actively seeking employment in the 3-4 weeks period immediately preceding the survey.

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[12] [a55]Actual. [b]Economist Intelligence Unit estimates. [c]Economist Intelligence Unit forecasts. [d]End of period forecast.

[13] Data gathered from a variety of sources, including: *Economist Intelligence Unit Country Profile*, 1998; World *Bank Country Economic Memorandum*, 1998; and documentation produced by Banamex's Division of Economic and Social Studies.

Projections prepared by CELADE in 1996[14] make clear that the EAP will continue to grow in the foreseeble future. The institution estimates that the EAP will be more than 53.3 million in 2025, while the total population will exceed 109.5 million. The average annual percentage growth rate of the EAP is about 3 percent between 2000 and 2025 while the average population annual growth rate is about 2 percent. However, if even the present 30 percent gap between new entrants into the labor market and the capacity of the economy to absorbe them remains the same, the number of people seeking jobs, migrants and, by definition, the informal economy will tremendously increase from present levels also.

I-C Mexican Migration to the United States

Mexico is far and away the leading source country for both legal and illegal migration to the United States. Given the large numbers of Mexican nationals who enter into the United States each year, and the absence of reliable Mexican or U.S. Government data on this flow of people (especially of the majority who attempt entry illegally), the Mission has no way of determining the real number of immigrants falling into the microentrepreneur/day laborer category. That said, the Mission believes a causal relationship may exist between business ownership and/or stable, full-time or better-paid employment in Mexico and individuals' perceived economic need to migrate to the U.S. to find jobs.

The development hyphotesis is that economic opportunity and improved income distribution significantly depend on microenterprise growth, because the formal sector will not likely have the capacity to absorb the increasing economically active population. This is especially so among Mexico's poor and disadvantaged in urban and rural areas. Since illegal immigrants mostly belong or derive from these two groups, it is the conclusion of the Country Team and the USAID Mission that without sufficient economic opportunities in Mexico, the tide of migration to the U.S. will likely increase. The U.S. Ambassador to Mexico stated the following in an interview published in July, 1999: "We have to acknowledge that this problem (of illegal migration) will continue for many years, until the Mexican economy reaches the point where there are fewer people who want to leave." He estimated that U.S. authorities would expel about one million Mexicans in 1999, out of 1.5 million seeking to cross the border without documents. Even poorly paid jobs in the U.S. are seen as a lifeline for many Mexicans who live in poverty at home. Official data show that 30 percent of working Mexicans earn no more than the *daily* minimum wage of about $3.60, and many in rural areas are paid far less. This compares with an *hourly* minimum wage of $5.15 in the United States.[15]

To test the hypothesis that there may be a linkage between microenterprise growth and migration to the U.S., the Mission will fund a case study in those areas which are the greatest sources of out-migration. Once a baseline is established, the numbers of people emigrating and

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[14] Celade. Demographic Bulletin No. 57, January 1996. It is possible that these projections are out of date already, since the actual EAP in 1997 was 38 million and the projection showed only 31.9 million for the same year.
[15] Yahoo! News, July 4, 1999.

the reasons for that emigration can be monitored, and the targeting of financial or other assistance to microenterprises can be better defined.

The Country Team's Mission Plan and Program (MPP) for year 2000 calls for USG assistance to accelerate Mexico's economic growth and distribute its benefits more equitably. The MPP recognizes that growth of microenterprises could be a vehicle for absorbing employment capacity, and therefore one key to addressing the clear lack of broad-based, equitable economic opportunity which may drive both legal and illegal emigration to the U.S. The Embassy created a new Economic Development Section in the FY2000 MPP to indicate that economic growth and job creation in Mexico are priority USG foreign policy objectives. The proposed USAID/M microenterprise strategy will make it possible for the Country Team to meet the foreign policy objectives outlined in the MPP.

A new focus on economic growth and opportunity for low-income segments of the Mexican population complements the USG'S programs to deter illegal immigration by making it more difficult and costly to enter the United States. Programs of deterrence and deportation are expensive, and it is not clear whether such practices actually have reduced the numbers of migrants who successfully elude law enforcement and remain in the U.S. illegally.[16]

The following data on U.S. immigration trends are illustrative.[17]

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[16] U.S. General Accounting Office. *Report to Congressional Committees on Illegal Immigration - Status of Southwest Border Strategy Implementation*. May 1999.

[17] The best and most recent source of data on immigration is the *1996 Statistical Yearbook of the Immigration and Naturalization Service*, U.S. Department of Justice, October 1997.

Legal Immigration

- The flow of legal immigrants has risen from 66,533 for the calendar year 1986 to 163,572 in 1996, more than doubling the annual rate over the course of one decade.
- By 1996, nearly 75 percent (or 122,679) of legal Mexican immigrants lived in either California, Texas or Illinois. Of all legal immigrants who indicated a preference to reside in Texas, California, or Illinois, Mexicans accounted for 56 percent, 32 percent, and 28 percent, respectively, of the total.

Illegal Immigration

- As of October, 1996, an estimated 5.0 million undocumented immigrants were residing in the U.S. This population is estimated to be growing by about 275,000 per annum. The largest number of illegal immigrants reside in California (2.0 million or 40 percent), followed by Texas (700,000 or 14 percent).
- Mexico is the leading country of origin for illegal immigrants: 2.7 million, or 54 percent of the total population of illegal immigrants, are of Mexican origin.
- An estimated 2.1 million people, or 41 percent of the total number of 1996 undocumented immigrants, were "nonimmigrant overstays," referring to persons who entered the U.S. legally, on a temporary basis, but failed to depart.

Estimates show that of those Mexicans emigrating to the United States in 1995, 52 percent came from the states of Jalisco and Michoacan; 23 percent came from the northen areas; 15 percent from the central regions; and 10 percent from the poor southern states of the country. In addition, 60 percent of all emigrants stated that they were employed prior to their departure from Mexico, while 40 percent claimed they were unemployed.[18] These figures may indicate that immigrants cross the border not only in search of jobs, but also in search of better-paid jobs. In both instances emigration signals a marked difference in employment opportunities in the two countries.

A study carried out jointly by the U.S. and Mexican Governments in 1996 stated that the population of Mexican-born U.S. residents ranges between 7 and 7.3 million persons. Of this figure, the study estimated that between 2.3 and 2.4 million individuals were illegal residents. Also, the study reported that 58 percent of all illegal aliens resided in urban areas.[19]

I-D Profile of the Microenterprise Sector

Prior to profiling the Mexican microenterprise sector, certain concepts affecting such an analysis must be defined.

In theory and in practice, terms such as "informal sector," "microenterprise," and "microfinance" take on a variety of nuances and there is no general agreement on working definitions, particularly between the way the U.S. and Mexico define those terms. Following is

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[18]Data taken from Mexico Social 1996-1998 Selected Statistics, prepared by the Division of Economic and Social Studies, Banamex-Accival Financial Group.

[19] Most official data reflect legal migration; data on illegal immigration are estimates only.

an explanation of how and why this terminology is defined for the purposes of this strategy document.

Definition of microenterprise. Given the wide range of microenterprises in Mexico and the relatively little information available concerning this sector, providing a precise definition of the target market is difficult. Furthermore, international donors like the IDB and the WB have distinct operating definitions, as does the GOM and private microenterprise support institutions. In this situation, it is best for USAID/Mexico to define microenterprise by the characteristics that all the above institutions recognize as defining traits: lack of access to formal sources of credit due to lack of collateral or credit history on the part of the borrower; microenterprises—both rural and urban—usually employ ten or fewer people including the microentrepreneur and any family worker; and operations are generally informally organized. For purposes of The USASID/Mexico micro strategy we also assume that microenterprises include agribusiness activities but not on-farm crop production.

In an attempt to establish size criteria, practitioners and their support institutions generally conceptualize the microenterprise sector as composed of three main strata or groups. In the first group—the lowest stratum—there are the very small "survival" microenterprises that are characterized primarily by women vendors operating small sales ventures from their homes or on the streets. They utilize very small amounts of credit, they do not generally generate much employment outside of their own family environment, and, therefore, are not willing, eager, or able to grow. These microenterprises may represent a demand for loan funds ranging from $50 to $500. The second group , or middle stratum, represents microenterprises that have outgrown the "survival" stage and have started to accumulate assets. They begin generating employment outside of their normal family environment, start making investments in fixed assets, and represent a demand for loan funds from $350 through $1,000. The third group, or highest stratum, comprises microenterprises that have started to expand their operations, are growth-oriented, and are seeking credit in the order of several thousands of U.S. dollars. Again, for the purpose of the USAID/Mexico microenterprise strategy the two latter groups will be addressed primarily, without making limitations based upon loan, asset, or investment ceilings.

The foregoing is in keeping with the most recent Agency policy guidelines defining the characteristics of a microenterprise, which are summarized as follows:[20]

1. The firm employs ten or fewer people, including the microentrepreneur and any family workers;[21]

[20] USAID Microenterprise Development Policy Paper, Section 1, Sebsection 1.A.

[21] The Mission could identify at least four different definitions of microenterprises used in México. NAFIN, INEGI and SECOFI (Microindustry Law) have their own definitions. In March 1999, the Official Newspaper of the Federation of Mexico published a new definition based on the number of employees only: 0 - 30 for industries, 0 -5 for commerce and 0 - 20 for service microenterprises. The National Institute of Statistics, in the *Encuesta Nacional de Empleo Urbano*, defines microenterprises as those firms with up to six employees, including the owner and both salaried and non-salaried employees. In the case of construction microenterprises, the maximum number of employees is set at 16.

2. The firm is informally organized and conducts business activities other than on-farm crop production;

3. The firm has a low level of assets or income.

In accordance with our assumptions and because of the wide range of definitions and size criteria, USAID/Mexico's strategy does not propose an imposition of loan or asset ceiling restrictions as criteria for providing financial or other assistance to potential microentrepreneur borrowers.

Definition of the microenterprise sector. Along with the emergence of a body of best practice techniques and set of nontraditional credit delivery systems, as microfinance has developed over the past twenty years it has been primarily associated with a specific clientele base: "the poorest of the poor." Informal sector NGOs, which represent the majority of microfinance service providers,[22] have focused primarily on the poorest of the poor. This association has had certain effects. First, the microenterprise sector has often been equated with the hard-core poor, when in fact this group is just one amongst various lower income population groups. Although often an important and sizeable group in developing country economies, the poorest of the poor do not constitute the entire microenterprise sector.

Second, the microenterprise sector in Mexico is not homogeneous, and there are varying degrees of poverty. This suggests that the exclusive focus on the lowest stratum in the income scale may have impeded the growth of a full-capacity microenterprise finance sector. In Mexico, the evidence suggests that people who may also be classified as microentrepreneurs and who have the capacity to improve upon and/or expand their business and create employment for others are not being assisted by neither formal or informal financial intermediaries, nor by government or donor-funded programs. As stated above, this is the ultimate target group for the USAID Microenterprise Strategy.

Notwithstanding the above commentary, microfinance institutions (MFIs) that focus on lending to the poorest of the poor remain an integral part of the USAID microenterprise strategy in the sense that they serve an important segment of the market. USAID/Mexico will not support these MFIs directly in order to enhance delivery of services to the poorest of the poor, although they will continue to receive such support.[23]

Third, in the case of Mexico, as will be further explained in Section III - Financial Sector, strengthening the capacity to mobilize savings at all lower-income levels, which in turn can help

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[22] Much credit should be granted to these institutions and their supporters, including USAID, as best practice techniques and credit methodologies have evolved from their collective experiences, and continue to provide a solid base on which to build future microfinance programs.

[23] Several examples of continued support to MFIs that focus on the poorest of the poor include: ADMIC is expected to receive a grant from the USAID Global Division this year, accompanied by technical assistance from Accion International, to help capitalize their transition from an NGO to a formal microenterprise lender; Santa Fé de Guanajuato enjoys state support to continue its work; CAME is almost self-sustaining and on its way to becoming financial self-sufficient; and Compartamos is transforming into a limited objective company (SOFOL) so it can begin to tap capital markets. Compartamos has already received about $2.0 million from USAID via a grant channeled through Acción International.

provide the capital needed for sustained economic growth, is a necessity. The poorest of the poor can and do save (mostly through Cajas Populares[24]), but whether the level of savings accumulated by the poorest of the poor can expand as rapidly as is needed remains unclear.

For the purposes of this strategy document the term microenterprise and references to the "target sector" and the "microenterprise sector," refer to subsegments within the lower income group which are positioned to contribute to overall economic growth in any form. This can be measured by potential for value-added, business growth, expansion and/or employment generation on the part of both borrowers and lenders.

The nature of microenterprise finance. Many formal financial sector intermediaries, including both social and non-social entities,[25] as well as certain international donors operating around the world and in Mexico, may not fully understand the nature and market potential of microfinance. First, microfinance includes consumer and production (microenterprise) lending. Second, microcredit transactions are often assumed to be a large proportion of microenterprise finance, when in fact credit is a distinct transactional subset within the broader category of finance. Third, savings and other like financial products are often left out of the microfinance concept even though they are often the most needed financial service. Fourth, social service-based financial intermediaries tend to assign a social mission to commercial, profit-generating transactions, and in so doing create certain conflicts with the incorporation of best practices into routine financial operations. And five, many regulatory bodies in developing countries often do not treat consumer credit and microenterprise credit as legitimate loan portfolio subsets, with the result that microenterprise loans fall under the consumer credit category. Inappropriately classifying microenterprise loans distorts portfolio risk weighting, the calculation of reserve requirements, and loan write-offs, to mention a few areas.

For the purposes of this strategy microenterprise finance is treated as a distinct transactional subset within traditional banking operations. As such it involves all the routine aspects of bank financial management (e.g., liquidity, risk, reserve requirements, capital adequacy, profitability, etc.).

Formal and informal microfinancial intermediaries. Two trends in microenterprise finance are emerging. In many developing countries, formal financial intermediaries are rethinking their traditional client base and the market potential of the microenterprise sector. Most financial intermediaries which have decided to "downscale" and extend operations into the microenterprise market have achieved extremely satisfactory operating results by combining selected microcredit best practices with prudential banking norms. A trend in the opposite direction is even more noticeable. Many NGOs are "upgrading" their operations, systems, and management routines, transforming themselves into formal financial intermediaries to expand outreach, improve financial service offerings, and achieve financial viability. Mexico shows

[24] A non-regulated credit union or credit cooperative.
[25] See Table No. 5 in Annex No. 2: the Financial Sector.

evidence that both trends are well under way, as evidenced by Crédito Familiar and Compartamos.[26]

Following we present a brief profile of the microfinance sector in Mexico.

In Mexico, what is most striking is the relative lack of progress and participation in microenterprise finance and other services. Given Mexico's apparent economic growth patterns and potential, it would be reasonable to expect that Mexico be well ahead of other less-endowed countries in providing assistance to microenterprises. In fact, Mexico is substantially behind in this area, with microenterprise finance and other services existing barely above a nascent level. The demand potential for microfinance services may be very large, but service is almost non-existent.[27]

1996 estimates showed that approximately 15.7 million persons, representing 44.6 percent of the total population which should be registered with the Ministry of Finance,[28] were operating in the informal sector.[29] Further estimate indicated that the informal economy accounted for 8.74 percent of total GDP. Table 3, presented on the following page, provides a profile of the microenterprise sector.[30]

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[26] These are two limited objective microfinance institutions (SOFOLs). For a description of each organization see Annex No. 3: Micro Finance Institutions in Mexico.

[27] For an approximate idea of the size and importance of formal and informal financial intermediaries see section on The Financial Sector.

[28] A business unit must be registered with the Government to pay taxes, to obtain an authorization to operate or to hire employees.

[29] Sources: *INEGI Encuesta Nacional de Micronegocios de 1996* and *Encuesta Nacional de Empleo.*

[30] Ibid.

42

Table 3 - Profile of the Microenterprise Sector [31]

Total Number of Microenterprises Sampled		**3,575,587**
By Activity Sector		
Manufacturing	415,935	11.6%
Construction	146,535	4.1%
Commerce	1,238,574	34.6%
Services	1,586,540	44.4%
Transport	188,003	5.3%
Sub-Total	3,575,587	
By Location		
With Business Place	1,037,836	29.0%
Without Business Place	2,537,751	71.0%
Sub-Total	3,575,587	
With Own Business Place		
Manufacturing	58,927	11.8%
Construction	2,376	0.5%
Commerce	277,793	55.4%
Services	159,823	31.9%
Transport	2,466	0.5%
Sub-Total	501,385	
By Age of Establishment		
Less than 6 years	2,006,077	56.1%
6 to 10 years	735,612	20.6%
11 to 15 years	326,373	9.1%
16 to 20 years	216,252	6.0%
More than 20 years	291,273	8.1%
Sub-Total	3,575,587	
No start-up financing required	655,889	18.3%
Start-up financing required	2,919,698	81.7%
Sub-Total	3,575,587	
Source of Start-up financing		
Banks	37,695	1.3%
Savings Institutions	21,804	0.7%
Friends/Family	538,309	18.4%
Money Lenders	58,680	2.0%
Personal Savings	1,879,861	64.4%
Liquidation of Former	197,887	6.8%
Client Credit	28,888	1.0%
Supplier Credit	87,074	3.0%
Other Sources	69,500	2.4%
Sub-Total	2,919,698	
No post start-up financing sought	3,045,184	85.2%
Of which		
No Further Credit Needed	1,669,177	54.8%
Used own resources	891,563	29.3%
Other	484,444	15.9%
Sub-Total	3,045,184	
Post start-up financing sought:	530,403	14.8%
Of which Financing Obtained	470,840	88.8%
Of which Financing not Obtained	59,563	11.2%

[31]Ibid.

43

The INEGI sample study[32] also indicated that only around 36 percent of total microenterprises sampled (3,575,587) were in some way registered with a government office. Also, around 63 percent were not registered with the Secretariat of Finance.

Commerce and service microenterprises represent around 79 percent of the total sample presented in Table 3, with service-oriented microenterprises composing about 45 percent of the total number. Although there are no sex-desagregated figures on microentrepreneurs, the majority of microenterprises surveyed that had interacted with MFIs were women, who represented the demographic group most commonly engaged in selling food and small merchandise on the streets or from their homes.

Of note concerning the INEGI survey, 92 percent of the microenterprises samples own fixed assets. Of these, 29.5 percent indicated that they had savings held in one form or another. Of the total sample, the study also reported that about 95 percent had profits. Eighty percent of those microenterprises indicating a profit are engaged in commerce and service activities.

The most important problems identified by respondents to the INEGI survey were lack of clients (40.2 %), lack of credit (1.5 %), excessive interest rates (0.2 %), lack of economic resources (6.7 %), low profits (18.5 %) and other problems (32.9 %).[33] These figures may indicate that, in spite of the need to obtain credit, the most important problem perceived by microentrepreneurs is a lack of marketing and/or management savvy.

Regarding the need for capital, 14.8 percent (530,403) of the total sample of 3,575,587 sought post start-up financing. Of this number, 88.8 percent obtained financing, leaving only 11.2 percent (59,405) without access to any type of credit. Funding was obtained mostly from friends/families (18.4 percent) and personal savings (64.4 percent). Banks provided only 1.3 percent of financing required. At first, it might look as if this figure (14.8 percent) is small. However, given the large size of the informal sector in México (an estimate of 15.7 million individuals in 1996), the actual total number of microenterprises that would have sought credit in the same year would have been 2.3 million (15.7 X 14.8). If, on average, only $100 in credit were granted to each one of these microentreprenuers, $230 million would be needed to satisfy total demand.

I-E Support of Other Donors

As stated earlier, Mexico is receiving relatively little support on this area. Mayor players include the World Bank (WB), the Intermerican Development Bank (IDB), the Ford Foundation (FF), the Interamerican Foundation (IAF), the Dejardins Development International (DDI), and the GOM trough "Nacional Financiera" (NAFIN, "Secretaría de Comercio y Fomento Industrial" (SEDESOL) and "Secretaría de Desarrollo Social" (SECOFI).

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32 The sample researched under the study (3.6 million) nationwide represents roughly, 23 percent of the estimated informal sector (15.7), which as described earlier, is the grand total in which all types (urban and rural) of microenterprises operate.

33 The latter category (other) is comprised of numerous problems identified in small percentages, such as: distance to the office, transportation, lack of childcare, inability to leave business unattended, etc.

The World Bank has just expanded its pilot Marginal Areas Project from 5 to 9 rural areas, and from $5 million to $10 million. The Bank will carry out integrated area development sub-projects in isolated areas with predominantly indigenous populations. An important feature of the Bank's Marginal Project Areas sub-projects will be their emphasis on establishing microenterprise as a viable source of income for poor indigenous peoples, which will also protect ecologically fragile areas. The Bank is open to the possibility of installing its project in or near one of two USAID/Mexico environmental project sites - probably in Chiapas or Oaxaca. There would not be direct working collaboration between the Bank and USAID. But each would be able to learn from the other's experiences in implementing sustainable rural microenterprise.

The Interamerican Development Bank has one relatively large regional microfinance training project ($2.1 million) with the University of Anahuac del Sur[34]. The project (which ends in December 2000) is heading to a strategic planning exercise after an interim evaluation carried out by the bank. Apparently, the results of the evaluation were not totally satisfactory to the bank that will be trying to reshape the project. The bank in Chihuahua, Nueva Viscaya, sponsored another innovative pilot training project. The program (Training and Employment to Micro and Small Enterprises) is being executed through the "Centro para el Desarrollo Económico y Técnico de Nueva Viscaya", attached to the Autonomous University of Chihuahua. The programs sends students to evaluate enterprises and based on these evaluation, the Center "sell" training and consultant services to interested enterprises. Once and agreement is reached, the Center hires consultants from a national database to provide the assistance needed. Students accompany these consultants and after they leave, students provide follow up. Generally, students are then kept as regular employees by the assisted enterprises. So far, the program has evaluated about 1,200 enterprises, and provided assistance to about 700 of them. The IDB is working on replicating this experience in Tijuana.

The IDB has one other proposed project loan that may impact the Mission's strategy. It is a Microfinance Access to Capital Markets Project. It would provide credit and technical assistance to microenterprises. The amount of the loan is $4.4. IDB has set its approval date for December 8, 1999.

Fhe Ford Foundation has been in Mexico for a number of years already. It has three areas of concern: strengthen the capacity of local institutions in the areas of research and public policy, support innovative microfinance models and strengthen networks of indigenous organizations and peer learning. The foundation has a budget of about $1.5 million a year which at times may expand to about $3.0 with recuperation of loans and the use of reserves. FF has been actively supporting Pro-Desarrollo in its efforts to affect changes in the legislation. The foundation is successfully capturing private sector donations from Mexican and American firms, e.i. Citibank and Hewlett Packard.

The Interamerican Foundation (IAF) responds to individual project requests without any specific area of interest except the poorest of the poor. Mexico is receiving more project funds than any other country. In FY 1998 it received$2.1 million for 12 different projects. During this

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[34] The IAFAD/COLCAMI program is described in detail in Annex No. 1.

same year, Pro-Desarrollo received $52,000 to carry out the Microenterprise Regional Forum aimed at discussing ways to better financial and non-financial services for microenterprises.

The Dejardins Development International (DDI) is a non-governmental institution located in Quebec founded in 1970. DDI is a component of the movement Desjardins, the largest financial institution in Quebec, Canada. In Mexico, DDI has only one three-year active project "MULTIPLICA" in León, Guanajuato through the state agency "Sociedad Estatal para el Financiamiento al Desarrollo (SEFIDE). The state-funded project will extend its support through August 2001. Areas of interventions are emergence and strengthening of credit unions and networks, legislation and regulatory frameworks and financial monitoring and security. The project is intended to develop financial services adapted to the needs of the poor and middle class individuals in the State of Guanajuato.

Nacional Financiera (NAFIN) is a public development bank. During the 50's through the 80's NAFIN was Mexico's main mechanism to finance large industrial plants and infrastructure projects. Today, NAFIN supports the modernization of the sectors most likely to participate in world markets, the creation of productive employment and the expansion of economic growth through microenterprise lending and technical assistance programs. However, its microenterprise program is very small and it did not render good results. Thus NAFIN has created a small and cumbersome microenterprise support program to have a few demonstrated success stories at a high administrative cost. As part of its general training programs, the institution has also developed a series of seminars on basic and advanced management skills and various programs to provide advisory services to its larger business clients.

SEDESOL and SECOFI programs consciously direct their subsidized resources to small and medium enterprises. SEDESOL funds are largely distributed on politically party lines to rural supporters. SECOFI's business training is for small and medium entrepreneurs only and is aimed at getting these businesses "certified". However, certification seems to serve no real purpose, so, much of the training is superfluous.

I-F Political and Policy Environment

The domestic political scene will be dominated by the legislative and presidential elections to take place in July 2000.[35] This implies that the rivalry between the government and the opposition parties is expected to continue and the passage of needed reforms will not be easily achieved during the remainder of the current government's term. Against this backdrop, overall economic growth is expected to slow in 1999, but should recover in 2000. That said, even though exports may benefit from the recovery in world commodity prices and renewed economic growth in Asia, electoral uncertainty is already causing some uneasiness among

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[35]These elections will be the most open in Mexican politics to take place in several decades. The two main opposition parties have the potential to dislodge the ruling Partido Revolucionario Institucional (PRI) from the presidency after 70 years of uninterrupted rule. While it seems as though the elections will be open and fair, the uncertainty surrounding what will be happening to the government in 2000 is already affecting the atmosphere. Possible new initiatives are taking on a distinct partisan tone, which are encumbering the achievement of needed regulatory reforms.

foreign investors. In addition, unless banking system reform and consolidation has been completed, MFIs will not be positioned to take advantage of improved conditions in international capital markets, or establish a steady flow of credit to microentrepreneurs serving the domestic market.[36]

I-G Conclusions and Implications for the Strategy

The implications of the current socio-economic scenario with respect to the design and implementation of a program in support of microenterprises are as follows:

- The socio-economic conditions of the country will be stable through 2000;
- The formal sector is not likely to increase capacity enough to absorb the increasing quantities of persons entering the labor force;
- Emigration to the United States—both legal and illegal—is likely to continue, if not increase, if more employment opportunities are not created in Mexico, and if the gap separating job quality in the two countries is not reduced;
- The microenterprise sector is large enough to sustain feasible financial intermediaries that utilize best practices;
- Capital need is not the only, nor necessarily the greatest, perceived need of microenterprises, even though it is the most often-herd MFIs complain. Other needs include marketing to find and maintain a clientele base, as well as management training and technical assistance;
- There is a need to support not only financial intermediaries, but also institutions that support the development of such financial intermediaries, to help satisfy the demands of microenterprises.

[36] Even though the GOM has bailed out the banking system by converting up to 60 percent of their portfolios into public debt (in the form of bonds), this solution has not enhanced liquidity. Furthermore, the remaining portfolio (40%) is not sufficiently sizeable to enable rapid growth.

II. THE FINANCIAL SECTOR

Although the Mexican financial sector comprises myriad institutional types—ranging from commercial banks to bonding companies—by international standards the financial system is poorly developed. With regard to the banking system, although it may have played an effective role in the early 1980s, ,banks were not prepared to service a growing economy by performing the intermediation function expected of them once the government adapted an outward-oriented, private sector-based strategy of economic growth.

As recent financial crises around the world have confirmed, a banking system influences the pace and sustainability of a nation's economic growth. Therefore, strengthening the Mexican banking system and expanding the provision of financial services is a matter of urgency. This is as true for microenterprise growth as it is for the development of small- and medium-sized enterprises (SMEs) in addition to large-scale companies.

This section discusses relevant financial sector issues which will influence the implementation of the Mission's strategy, beginning with an overview of the current body of laws and regulations governing financial sector operations.[37]

II-A. The Legal and Regulatory Framework

Toward the end of the 1980s, key economic reforms triggered a growth spurt in the financial system, particularly in the commercial banking subsector. At the time, GOM initiatives included the re-privatization of commercial banks, the dismantling of interest rate controls, the revision of financial sector legislation, the elimination of capital controls, and the easing of reserve requirements, which in turn freed up commercial bank reserves used by government for directed lending.

Unfortunately, progress made in financial sector strengthening was more superficial than real. Despite efforts to privatize financial intermediaries and liberalize formal sector financial operations, a strong legal and regulatory framework has not been introduced, and key legislation regarding deposit insurance coverage and norms relating to secured lending and bankruptcy has not being promulgated. Commercial bank ownership in many cases was in the

[37]We omit from this discussion a number of institutions which are part of the broad financial sector, such as securities brokerage houses, insurance companies, bonded warehouses, foreign exchange houses, leasing, factoring and bonding companies, and so forth. For the purposes of this report, the focus is on intermediaries which extend traditional financial lending services and mobilize savings. We also omit from the discussion consumer credit, in spite of the explosion of in-kind consumer credit to the poor provided by merchandizing chains, such as Elektra, and in spite of the fact that some of the consumer credit now provided may be channeled to microenterprise productive activities and vice-versa.

hands of individuals and groups lacking in banking acumen. This was not counteracted by a strong system of bank supervision. Indeed, supervisory skills had degenerated during the previous two decades as banks functioned as little more than mobilizers of funds for the government. The situation was one which invited moral hazard and insider lending and rendered the banks vulnerable to a crisis, as occurred in 1994-95. Although the GOM response to the financial crisis prevented a total collapse of the banking system, at present the financial sector remains highly vulnerable, formal financial intermediaries continue to be extremely risk-adverse, and private sector lending is still declining.

The body of laws and regulations governing the formal (regulated) financial sector, summarized in Table 4, is both complicated and confusing.

TABLE 4: The Legal Framework and Financial Institutions

FRAMEWORK	PROVISION
National Constitution (*Constitución Política*)	• Social sector identified as a legitimate, distinct sector of the economy, capable of conducting economic activities in parallel with the private, non-social sector; • Cooperatives identified as an organizational form of workers.
Civil Code (*Codigo Civil*)	• Recognizes trading companies (*sociedades civiles* or *mercantiles)*, cooperatives, and credit unions as legal persons (*personas morales*) with legal capacity to operate.
Law of Trading Companies (*Ley general de Sociedades Mercantiles*)	• Notes that cooperatives will be governed by special legislation; • In effect, makes civil and commerce or trading societies (*sociedades civiles*[38] *y mercantiles*) become one and the same.
Commercial Code (*Codigo Commercial*)	• Persons who "accidentally" operate any type of business with or without a fixed place of work is subject to the commerce or trading laws and will be considered a trader (*comerciante)*; • Requires all *traders* to register with the government authorities.
Law of Cooperatives (*Ley general de Sociedades Cooperativas*)	• Cooperatives offering financial services are controlled by the Ministry of Finance and Public Debt; • State/municipal governments, in accordance with delegated authority, may also supervise cooperatives.
Law of Credit Institutions (*Ley de Instituciones de Crédito*)	• Establishes commercial (*multiple purpose banking*) and development banks as the two institutional types offering traditional financial services (loans and savings mobilization); other institutions offering these services are not qualified as institutions *"de Banca y Crédito"*; • Establishes SOFOLs (*Sociedad Financiera de Objeto Limitado or Limited Objective Financial Society)*, under the Ministry of Finance and Public Debt and supervised by the CNB (*National Banking Commission*), and authorized to mobilize financial funds via registered market financial instruments and extend credit to limited sectors for predetermined and authorized activities; • Social sector organizations authorized under Article 25 of the Constitution may conduct savings and credit activities with proper authorization and at the discretion of the Bank of Mexico.
Law on Auxiliary Credit Organizations & Activities (*Ley general de Organizaciones y Actividades Auxiliares de Crédito*)	• Identifies two social sector Financial Intermediaries, Savings and Loan Associations (*Sociedades de Ahorro y Préstamo or SAPS*) and Credit Unions as credit auxiliary organizations, calling for them to be formed as public corporations (*sociedad anónima*), with financial services restricted to their membership and deposit taking on a term basis only. Places strict limitations on both SAPS and Credit Unions.

[38] A civil association (*asociacion civil*) is a not-for-profit association of natural persons that carries out activities in the general interest of society.

TABLE 4: The Legal Framework and Financial Institutions (continued)

Regulation of the Social Sector (Article 25) of the Economy (April 1999)(*Ley reglamentaria* (Articulo 25) *del Sector social de la Economía* (April, 1999))[39]	• Expands the definition of social sector institutions and their permissible activities; • Creates three new entities: the National Council for Social Sector Entities (*Consejo Nacional de Entidades del Sector Social),* to formulate, coordinate, and program national strategy for the social sector; the National Institute of the Social Sector Economy (*Institute Nacional del Sector Social de la Economía),* as the supervisory agency for social sector institutions; and the National Register for Social Sector Entities (*Registro Nacional de Entidades del Sector Social),* to accredit social sector institutions.

As a result of legislative fragmentation, the financial sector is also highly fragmented into the types of institutions presented in Table 5.

[39] By the terms of the Regulatory Law (*Ley Reglamentaria*), authorities have established a variation on rural savings and loan cooperatives, which are called *cajas solidarias. A caja solidaria is* structured as a public association under FONAES and SEDESOL, and is not formally supervised by FONAES. *Cajas solidarias* now form an integral part of the social sector.

TABLE 5: Formal Financial Sector Intermediaries in Mexico

SOCIAL SECTOR FINANCIAL INSTITUTIONS		
Entity	**Institutional Type**	**Authorized Operations**
Savings and Loans Cooperatives	Limited liability cooperative	Lending and savings mobilization schemes
Savings and Loans Companies (SAP)	Limited liability auxiliary societies Credit organization	Lending and deposit-taking amongst membership
Credit Unions	Limited liability company Auxiliary credit category	Lending and deposit-taking in form of loans and term deposits
Cajas Solidarias	Civil association	Credit cards, fixed-term deposits and group lending
Associations	Civil association	Lending via financial intermediaries
NON-SOCIAL SECTOR FINANCIAL INSTITUTIONS		
Commercial Banks	Fixed capital corporations	Traditional commercial-banking services
Development Banks	Public-sector companies	Tradition commercial-banking services
Limited Finance Companies (SOFOLs)	Private-sector limited objective corporation	Mobilize savings through sale of stock
Public Trusts (Fideicomisos)	Public-sector agencies	—
National Savings Trust (Patronato del Ahorro Nacional - PAHNAL)	Public-sector savings organization	Savings mobilization (small scale and time deposits)

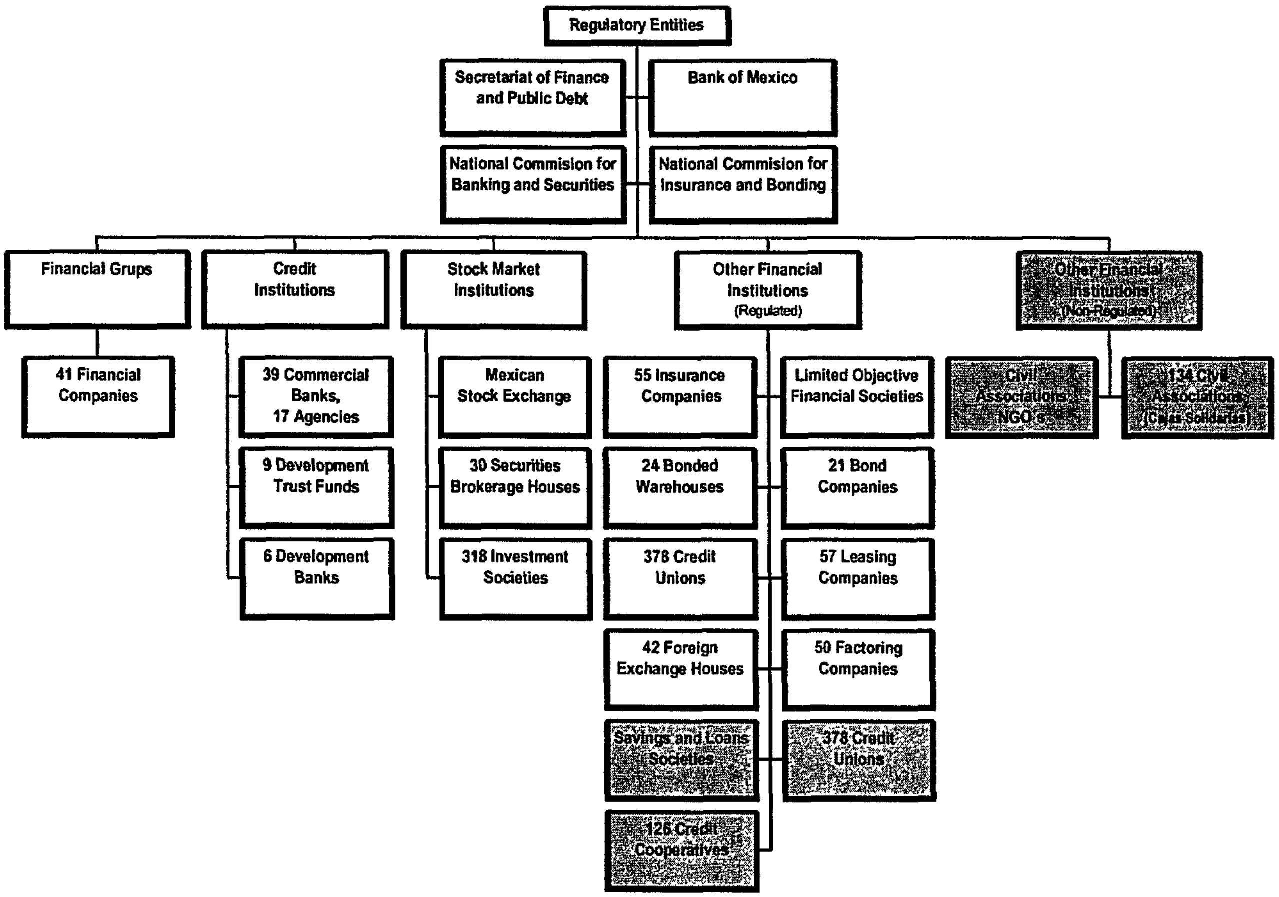
The Mexican financial sector, including both social and non-social institutions, is regulated and supervised by the Secretariat of Finance and Public Debt (SHCP), the National Commission for Banking and Securities (CNBV) and the Bank of Mexico (BM), a tripartite division of authority resulting in further fragmentation. In spite of this regulatory structure, in practice non-bank

51

social financial organizations are operating with little or no regulation and supervision.[40] According to Mexican experts interviewed by USAID/Mexico, the GOM—including the Central Bank—are too busy managing the commercial-banking crisis to appropriately supervise microlenders. Furthermore, as previously noted, most government officials share the belief that microentrepreneurs (i.e., the informal economy) will cease to exist should the mainstream Mexican economy grow fast enough to absorb those individuals informally employed at present.

The supervised and regulated financial intermediaries are arranged in the following three-tier system:[41]

Figure 1: Mexican Financial System Structure



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[40] For example, the Cooperative Law was amended to include savings and credit cooperatives as regulated and supervised institutions under the CNBV, but the detailed regulatory framework that would allow this amendment to be implemented was never passed. In practice, these cooperatives are capturing savings without supervision.

[41] It was not possible to obtain aggregate numbers of clients and business volumes at this stage.

52

The non-regulated financial institutions presented in Figure 1 include some 126 credit cooperatives, 134 regional *cajas solidarias*, 250 village banks[42] and numerous NGOs.[43] Since non-regulated civil associations and NGOs are not registered, it was impossible to obtain data on their exact numbers or volumes of operations. Boxes shaded in gray are called social sector financial intermediaries. As can be seen above, the social financial institution sector consists of both regulated and unregulated financial intermediaries.

In the absence of agregate official data, private officials interviewed expressed that most cajas solidarias are in very difficult financial and economic conditions. Due to resource constraints, the Mission elected not to include them in the strategy at this moment. As the strategy is implemented in the near future, the Mission will look into the possibilities of identifying and working through the most important and sound ones, specially those functioning in rural areas.

A publication prepared for presentation at the *First National Forum on Cooperative and Solidarity Financing* in September 1998 provides an idea of the relative importance of the social sector in Mexico. Total assets of the social sector represent 0.27 percent of those of the bank sector. The social sector's loan portfolio was 0.34 percent of the bank sector, and savings represented 0.89 percent. The social sector has 1,046,433 members, about $400,000 in loans, and approximately $550,000 in savings.

Savings face a distinct set of problems. A key issue is the lack of legal protection, which has caused repeated scandals in the non-social sector as a result of owners absconding with depositors' funds. Thus, one of the most important issues to be addressed via enhanced legislation is a method for protecting depositors and shareholders in all deposit-taking institutions. Another problem is the internal administrative and financial weaknesses evident in these institutions. Savings management alone shapes operations, information technology, risk handling, internal controls, human resources, and marketing . This problem will be addressed under the proposed strategy through the provision of training and technical assistance.

The principal needs of microfinance institutions are capital, management training, and technical assistance, all of which can support MFIs transformation into viable financial institutions. Even the most advanced institutions have identified a need for training and technical assistance on microcredit and savings technology, financial administration, marketing, human resource management, cash management, and inventory control, among other issues. Given the proper training and technical assistance, MFIs could easily manage ten times as much capital as they do at present,yet still serve less than 1 percent of the potential demand for credit, which was conservatively estimated at $230 million in Section II.

In the aftermath of Mexico's 1995 financial crisis, the entire banking system is severely undercapitalized, suffers from liquidity problems (limited resources and few incentives to conduct traditional financial transactions), disclosure problems (what, how, and when to make financial information public), and strained relations between banks and borrowers because of relative insecurity. In addition, non-bank institutions and social sector financial intermediaries

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[42] A village bank is an informal group of 20-30 individuals—mostly women—who gather periodically to receive loans and save.
[43] Ibid.

are under market and GOM pressure to serve the clientele not covered by commercial banks. The GOM has addressed these various problems with a mix of institutional reform, such as consolidation of the regulatory authority in a single entity, the CNBV, as well as legal amendments, includingchanges that facilitate foreign investment.

The compounding of all these problems have led to a severe credit crunch. Very little credit is available at present throughout the entire financial system. In addition, there is a severe restriction of capital in the form of credit in the non-bank social financial sector. Virtually all financial intermediaries are undercapitalized, do not capture savings in great numbers, are unwilling to capture savings due to internal weaknesses, or are obligated to channel their savings to the non-social bank sector because of legal restrictions.[44]

While the government remains preoccupied with resolving the crisis in the formal non-social banking sector, little has been done to amend legislation pertaining to non-bank social sectors, much less the myriad of microfinance institutions (NGOs) operating outside of the legal and regulatory framework. With respect to the latter, apart from inherent weaknesses in management and systems, research suggests that the incentive system,—specifically the tax liability accruing to formal sector financial intermediaries—is a major obstacle to the expansion of financial service offerings.

II-B Conclusions and Implications for the USAID/Mexico Strategic Plan

The Mexican financial sector has undergone nationalization (1982), privatization (1991-92), experienced a credit boom (1992-94), a deep crisis (1995), and has been caught in a domestic credit crunch (1996-present). Throughout this period, the legal and regulatory system has continued to present significant obstacles to financial market development with the result that MFIs are still not positioned to perform the financial intermediation role needed in a modern economy. The compounding of these various factors has created large-scale fragmentation and stymied organizations that want to grow.

Reform is required primarily in two areas . First, the legal code must be strengthened in order to protect the rights of creditors and shareholders. In this regard, an effort must be made to improve property registries, and thereby permit movable property to be used for loan collateralization. In addition, Mexican bankruptcy law is seriously inadequate, which encourages poor loan repayment practices, and in turn impairs bank portfolios and weakens creditor rights.

Second, the enforcement of laws and contracts, as they exist at present, must be strengthened and improved. An improved legal and regulatory framework cannot be operational in the absence of an efficient judicial system capable of enforcing such laws. While recognizing that regulatory reform is an issue that goes beyond financial sector strengthening *per se*, a weak judicial system translates into undisciplined debtor behaviors and discourages banks from lending to new entrepreneurs on the basis of formal, contractual arrangements.

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[44] Non-bank social financial intermediaries are described in the next section.

Unfortunately, no quick solutions to the many problems affecting the financial system exist. Additionally, in view of the primacy of the upcoming 2000 elections, the government is most likely not willing to make needed changes, as they may threaten vested political interests .[45] Due to this issue, USAID/Mexico will not dedicate scarce resources to promoting financial sector policy reform directly. Rather, the Mission will work within the existing legal and regulatory framework, focusing on capacity-building efforts in support of those formal social and non-social sector financial intermediaries which are servicing and/or positioned to service the target sector. The Mission will also work with those microenterprise support institutions that have already begun to work onpromoting legislation changes, such as the Mexican NGO Pro-Desarrollo and the Mexico Citybased Ibero-American University.

The focus on formal sector intermediaries—both social and non-social—and on their support institutions is put forward in view of the following considerations:

1. The key objective is to stimulate growth of microenterprise and employment. Improved legislation will eventually support this objective, but is not necessarily critical to achieving the strategy's objective.

2. Working with the formal financial sector will help to bridge the gap between large export-oriented firms and smaller enterprises that have restricted access to financing for business expansion and modernization. In so doing, it may also be expected that smaller domestic firms become downstream suppliers to businesses engaged in exporting and/or become exporters themselves.

3. In order to promote sustainable, balanced and equitable economic recovery the Mission will focus on those microenterprises and small-scale economic agents which actually contribute to economic growth.

4. Non-bank social financial institutions need be strengthened to maximize the mobilization of domestic savings and improve the allocation of financial resources, and overcome the impediment of under-capitalization.

5. Research suggests that outreach is best achieved and maintained by financial intermediaries which operate on the basis of sound prudential norms within a regulatory and supervisory framework (which is itself based upon international standards). In addition, formal intermediaries are better positioned than informal sector microfinance institutions to move financial resources across regions effectively and efficiently.

6. To be useful, credit should respond to the diversity of economic activities in which microentrepreneurs are engaged because their endeavors have very different cash flows and

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[45] Indeed, some efforts currently underway (e.g., congressional committee work on legislation for large enterprises) have taken a distinct partisan note.

investment requirements. This calls for more than one lending technology,[46] rather than a predetermined, selected, or limited-client approach.

7. Change in the regulatory system will be better achieved if interventions are aimed at supporting those institutions that have already been working for some years on the subject, and have the experience, contacts, and political support.

8. Research on the microenterprise sector would be better carried out, their results better accepted, and recommendations implemented, if such research is performed by publicly recognized Mexican institutions, such as the Ibero-American University or Pro-Desarrollo, rather than directly by USAID/Mexico.

In view of these points, the Mission will focus its support and resources on a pilot group of microfinance intermediaries and their support institutions. Based upon the field work conducted to date, these institutions include Crédito Familiar, Financiera Independencia, FinComún, Patronato del Ahorro Nacional, the Ibero-American University, Pro-Desarrollo and the Institute for Alternative Development Finance at Anahuac University (IAFAD/COLCAMI). Other social sector institutions that may be incorporated include: Compartamos, ADMIC Nacional, Fundación Mexicana para el Desarrollo Rural, Ahorro, Microcrédito Santa Fe de Guanajuato, Centro de Apoyo al Microempresario, and the Mexican Association of Credit Unions from the Social Sector (AMUCSS). Grupo Progreso, the Fondo Méxicano para la Conservación de la Naturaleza, and Fundación Yucatán may be incorporated in order to carry out the environmental component of the strategy.

Annex No. 3 contains a brief description of each one of these proposed partners.[47]

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[46]The following best explains what is meant by lending technology: "(...) a systematic method of allocating and recovering loans that includes an information component (i.e., screening, monitoring, and enforcement of credit contracts) and an operational component (i.e., physical infrastructure, personnel, and internal control). Such a method determines the fixed and transactions costs involved in financial intermediation." Cited in Mexico: Rural Financial Markets, World Bank Report No. 14599-ME, August 25, 1995, page 68.

[47]For this strategy, more than 30 institutions, NGOs, agencies, and associations were investigated. Time did not permit conducting in-depth institutional assessments and financial analyses of the many institutions and intermediaries visited. For the most part the information contained in these brief overviews was gathered during interviews and from published material. Only three institutions were analyzed in an in-depth fashion: Crédito Familiar, FinComún, and ADMIC Nacional.

Annex No. 3.-

Microfinance Institutions and Their Support Organizations in Mexico

In preparing this strategy, documentation was reviewed pertaining to credit unions, savings and credit societies, and non-bank specialized organizations. Following is a brief summary of each institution and its lending and support methodology. In most cases, the information was not confirmed, audited, or compared against other sources. Rather, the synopses only reflect the information provided directly by each institution. At the time this strategy was being finalized, a selected group of microfinance institutions were being analyzed in a more in-depth nature. A summary of the findings of these audits are incorporated into the write-ups provided below; complete evaluations are included as additional annexes.

Crédito Familiar, S.A. de C.V. (SOFOL). Crédito Familiar began operations in 1996 as a SOFOL owned by a Mexican commercial bank: BANCOMER, which owns 51 percent of its capital, and by CitiFinancial, previously named Commercial Credit,[1] which owns 49 percent. Crédito Familiar is regulated and supervised by both the Finance Ministry -SHCP and by the National banking Comission -CNBV. Though Crédito Familiar operates independently of Bancomer, its is considered part of it and is subject to the same laws and regulations applied to banks..

Crédito Familiar is legally restricted to lend to individuals. Until it is able to place commercial paper, funding for the loan portfolio comes from BANCOMER, which has provided US$ 6 million, in addition to US$ 6 million in equity provided by both partners. The partners plan to increase equity by US$ 4 million in January of the year 2,0000. Of its $5.7 million loan portfolio (as of October 1999), 70 percent is oriented towards consumer credit and the remainder is directed towards microenterprises. Within its credit portfolio—which is characterized by a desertion rate close to zero—the intermediary maintains 9,700active clients.[2] The institution's delinquency rate (measured by risk or the size of its contaminated portfolio) of up to 90 days is 1.6 percent. The delinquency rate of up to 30 days is 0.98 percent. Crédito Familiar has spent heavily on branch expansion, financing it with equity and with operational income. It expects to break even during 2,002. The principal cause for the institution's success, appears to be the result of the criteria used in approving consumer loans obtained from its U.S. partner and by the careful analysis of micro enterprises' income streams. Only employees and self-employed individuals with some disposable income may borrow from Crédito Familiar. The institution applies several "best practices" criteria for carrying out microenterprise lending, including: lending based upon capacity, close supervision of active loans, and systematic follow-up with customers.

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[1] A U.S.- subsidiary of CitiGroup, CitiFinancial is focused on the individual, micro and small-business markets.

[2] Desertion rates of 30 to 35 percent affecting microenterprise credit programs are not unusual. Deserters are clients who do not request further credit after a few loans because they do not need additional financing, move, have found other credit sources, or do not wish additional credit for for other various reasons. A repeat borrower is not considered a deserter if denied further loans by the MFI because of delayed or non-payment.

Crédito Familiar began as a one-branch operation in 1996, opened a second branch in 1997, and 11 more in 1998. At the moment, the institution operates 127small branches, each one operated by eight staffers. The branches are, located near or around locations in which consumers and microenterprises live and operate. Crédito Familiar expects to open 15 additional branches in 2,000, slowing branch growth in 2,001 and building the portfolio at each branch until it breaks even in 2,002. Then it plans to open 20 to 25 additional branches every year thereafter. The institution long-term strategic plan calls for growing its franchise to between 300 and 400 branches within the next few years in order to serve approximately 400,000 clients. In this regard, the major difficulty and potential source of weakness faced by Crédito Familiar will be continuing to secure an adequate number of qualified, capable personnel, including managers, accountants, and credit officers. The information system used by Crédito Familiar was supplied by CityFinancial and subsequently adapted to the Mexican operating environment. Crédito Familiar is designing a marketing program to develop loan demand.

Crédito Familiar is interested in examining ways to tap savings and to enter rural credit. The firm is interested in participating in discussions concerning microenterprise finance, in becoming a a member of Pro-Desarrollo and becoming a user and investor in the credit bureau. Crédito Familiar is also interested in tapping funding for its micro enterprise portfolio, to complement those already utilized.

The Mission is considering forming a partnership with Crédito Familiar for the following reasons:

- It already serves the target sector and its current loan portfolio appears healthy.
- It has planned for the expansion of its branch network and outreach programs.
- Accessing capital and financial resources is not a major concern.
- It operates in accordance with the same sets of supervisory norms and regulations governing the operations of its commercial bank.
- In terms of ownership structure and oversight, it is directly linked to the commercial banking sector and therefore represents an opportunity to bridge the gap between the social and non-social banking sectors.

Grupo Progreso. The following information is based on two visits to Grupo Progreso, in July and November of 1999. Established in 1977 by a small group of forward-looking farmers in Delicias, Chihuahua, as a farmers cooperative, Grupo Progreso continues to focus on irrigation-assisted agriculture conduct in a valley in the Chihuahua desert surrounding the town. The valley produces pecans, peanuts, and bell peppers, in addition to 60 percent of the jalapeño peppers that are exported by Mexico. Grupo Progreso serves the communities of Delicias, Rosales, Meoqui, Camargo, and Cardenas.

Grupo Progreso now consists of seven business entities, each one managed by the same board and the same central management team. The flagship unit is the Credit Union, established in 1977. The Credit Union now boasts a depositor base of 320, with deposits totaling $10 million and a loan portfolio of $10.5 million. Loans are directed towards enterprises engaged in agribusiness, services, industry, and commerce. The maximum loan amount is $525,000, but this is being lowered to $210,000. The credit union also administers a goverrnment microentrepise loan program - FIDEAPECH - with a current portfolio of and loans ranging from $400 to $13,000 lent at market interest rates. The a mount lent to date is $747,000.

The other six entities in the group include:

1. A Savings Center with a membership of 5,500, a deposit base of $5.2 million and a loan portfolio of $300,000. The Savings Center extends loans in amounts up to $2,100. The amount lent in 1999 to date is $484,000.
2. A Development Unit with a membership of 200 which extends loans of up to $15,000 and maintains an overall loan portfolio valued at $500,000.
3. A Crop Insurance Fund which has 280 members and a capital reserve of $900,000.
4. A Supply Stores unit with a membership of 220 and net worth of $4.5 million.
5. An MIS Unit which services Grupo Progreso and its members and has planned to purchase an integrated bank management software program. The unit has a net worth of $70,000.
6. An Exchange Unit with 320 members and a net worth of $170,00.

Each of these entities operates as a cost center and has achieved self-sufficiency. However, in order to reduce operating costs these entities share some of the same personnel and equipment.

Loans to microentrerprises are made from the Savings Center, the FIDEAPECH program and the Development Unit. A salient point is that a number of loans have been made to start-up enterprises, which is a niche in the microfinance market that is usually not served by MFIs. In addition, a number of loans have been to enterprises which help protect/conserve, the environment. Some examples are for reforestation, production of organic fertilizers, use of solar energy for water pumps, use of gas fuel instead of tires for brick production, etc. In addition, there is an environmental clause in all loan contracts.

Grupo Progreso offers diversified financial services of low cost and high quality to rural farmers, agribusinesses, microindustries, services and commercial enterprises who otherwise have limited or no access to formal financial services. In addition, a number of non-financial services are offered for a fee to microenterprises that are helping to "break the barriers of the informality". One such service is fiscal accounting which takes over the accounting function for the entrepreneur and organizes it so that the appropriate taxes can be paid. This acts as an incentive for the informal enterprise to become formalized.

An advantage of the credit given to one client interviewed was that he will not have to return to the U.S. to work. This is because his business has grown to the point with the series of loans from Unión Progreso that he can now support his family with the income from his carpentry business. He also mentioned that had he known about Unión Progreso earlier he would never have migrated to the U.S. to find work.

When the results of the institution's operations produce a surplus, dividends are distributed to members and used to recapitalize the group. Given the Board's careful governance structure and management's progressive vision, Grupo Progreso has become successful despite the fact that its members are medium- and low-income farmers. The institution is operated on sound business principles, particularly with regard to financial intermediation.

Grupo Progreso management believes that its successes have been notable and could be replicated throughout Mexico. The institution would welcome USAID/Mexico technical assistance in order to expand operations across the State of Chihuahua, and eventually nationwide. Furthermore, assistance would be utilized to fine-tune its microcredit lending technology.

The Mission is considering working with Grupo Progreso as a partner institution for the following reasons:

- As a credit union, it is a formal social sector FI.
- It would be the only counterpart financial intermediary specifically financing rural agribusinesses and counts among its client base farmers cultivating jalapeño peppers for export.[3]
- It has been very innovative in establishing a series of operations which service the various needs of its clientele.
- It is financially and operationally sound and thus well positioned to expand successfully.

FinComún. The information presented below is the result of one visit made in July to the MFI and an in-depth institutional analisys carried out in October/November of 1999. The institution began operations as the Juan Diego Foundation with a mission to provide financial services to both marginal groups and the poor residing in Mexico City. The institution has based its operations on Banco Caja Social in Colombia. In 1994, FinComún was granted a license to operate as a credit union. As such, all clients became shareholders and the ownership share of the Fundación Juan Diego was reduced to 20 percent. The stated objective of FinComún is to alleviate the structural causes of poverty.

The Board of FinComún is composed of highly successful businesspersons who wish to support microfinance in a systematic and professional manner. The current management team created the institution and has developed an innovative lending technology based upon the substantial application of state-of-the-art technology and the use of computer systems for financial control.

FinComún branches have opened in sections of Mexico City where large groupings of low income microenterprises may be found, but where financial services are not offered by other organizations. FinComún provides microcredit and has developed special mechanisms to permit savings mobilization. Management would welcome assistance from USAID/Mexico in order to deepen, strengthen, and expand their operation.

FinComún currently maintains 6,284 clients, 11 branches, and a loan portfolio valued at 18.8 million pesos (of which 7.5 million pesos are in loans to microenterprises). The institution manages 22.2 million pesos in savings and about 47.0 million pesos in fixed-term deposits. The delinquency rate for FinComún's credit portfolio is currently 4.7 percent.

At the present time FinComún has not achieved a break-even point due primarily to two factors:

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[3] The United States accounts for 60 percent of the jalapeno market.

1) The bulk of the assets are in investments (lower return). Only 10.7% of productive assets are in loans to microenterprises (higher return). The weighted average interest rate is 35%. This would increase if a larger proportion of assets were in loans to microenterprises. FinComún recognizes the need and desirability to shift the balance of its assets to loans to microenterprises.

2) relatively large infrastructure in terms of personnel

However, FinComún is projecting a substantial increase in loans to microenterprises next year (from 1,000 currently to 4 – 5,000) and in the years that follow. The use of advanced technology - Palm III for loan processing and a "smart card" with a credit line - should increase the ratio of clients per loan officer, which currently is somewhat low (57).

A salient factor about FinComún is that they have never used donor funding or commercial bank loans for loan capital. All of their resources come from passbook savings, term deposits and investments of members. They use a daily "gap analysis" to assure that these liabilities are covered by equivalent term investments in commercial paper.

Another factor worth mentioning is the low delinquency rate (2-4% using portfolio at risk). This is due to very close monitoring of borrower loan payments and rapid follow-up using an information system which functions as a network.

The Mission is considering FinComún as a partner for the following reasons:

- As a credit union, it is a formal social sector FI.
- FinComún has a unique approach to microenterprise finance which may be applied successfully in other settings and therefore merits close monitoring.
- FinComún services a market niche—the urban poor—not targeted by the other FIs being considered to participate in the USAID/Mexico strategy.

ADMIC Nacional, A.C. ADMIC was created in 1980 as a non-profit institution organized as a *sociedad civil* headquartered in the City of Monterrey, in the state of Nuevo León.

The institution's mission is to support the microenterprise sector and therefore reduce unemployment and improve income within a framework that promotes economic activities via individual creativity inherent in a free-enterprise system.

ADMIC's has concentrated on providing credit, technical assistance, and business training to entrepreneurs that do not otherwise have access to such services. ADMIC is interested in supporting groups that wish to grow financially, engage in productive activities, have no financial experience, currently receive financing from money lenders , have no or few resources to guarantee loans, and have no access to the formal financial system.

During the first 15 years of operation, ADMIC provided financial, administrative, and business training services under Nacional Financiera's (NAFINSME lending program. This initial focus centered around the provision of large individual loans backed by traditional guarantees on the part of clients. The target clientele consisted primarily of large enterprises involved in the manufacturing or services sectors. During this period, ADMIC provided business consulting services to 193,890 enterprises, and offered 6,015 training sessions to 72,908 attendees. Moreover, ADMIC disbursed 30,941 loans totaling about $62 million to nearly 8,000 clients,[4] averaging $2,003 per loan. NAFIN suffered from large-scale defaults as a result of the economic crisis in 1995, which nearly resulted in the termination of NAFIN's microcredit program. However, ADMIC was able to reach an agreement with NAFIN in early 1998, by which the portfolio—then valued at $8.0 million —was purchased for $2.5 million in cash. ADMIC expects to recover only between $4.0 million and $5.0 million of the old NAFIN loans by early 2000.[5] ADMIC continued to provide non-financial services through all of its branches.

Recently, ADMIC began a process of consolidation and cost rationalization at the national level that has led directly to a reduction in the size of its branch network. Of the 41 branches that ADMIC operated for NAFIN in 16 states in 1995, ADMIC now operates 16 offices dedicated to recovering its negotiated NAFIN portfolio, seven ranches dedicated to microcredit lending, and three branches devoted to consumer credit. These 26 offices are located in 13 states throughout Mexico. Despite the drastic changes in operations, ADMIC has re-trained its in-house management consulting staff. The institution would like to use this staff to provide technical assistance to microenterprises; however, the cost-effectiveness of such a venture has yet to de determined. Within the next year, the branches ADMIC dedicates to recovering the NAFIN portfolio will be either phased out or transformed into branches centered on providing microcredit.

In late 1998, ADMIC embarked on a new stage in its institutional life by launching a microcredit program aimed at providing credit to very low-income clients using ACCION's solidarity group and individual lending methodologies. Between November 1998 and April 1999 ADMIC granted 1,942 credits totaling $437,017, or an average of $225 per loan. The reported delinquency rate for this portfolio is 1 percent. Additionally, 81 percent of all loans are held by individual women borrowers and, with the remaining 19 percent in the hands of solidarity groups comprised mostly of women. In terms of geographic distribution, 49 percent of the loan portfolio is held by clients in the State of Monterrey, followed by the State of San Luis Potosí (20%), the State of Victoria (19%), and the State of Tampico (12%).

To better adjust its financial products to the needs of its clientele, ADMIC maintains three microenterprises classifications. First, subsistence microenterprises, which are defined as urban and sub-urban economic units formed by an owner and up to three additional family members, characterized by a maximum of $1,000 earnings from annual sales. Loans are granted to individuals if a guarantee can be provided or to solidarity groups with a maximum of five members. Loan amounts vary between $50 and $500, depending on the client's payment capacity. The maximum terms available on loans are 12 weeks. Clients in this category must re-pay loans via in weekly, bi-weekly, or monthly installments. Second, simple accumulation microenterprises, which are identified as urban and sub-urban economic units formed by an owner and up to six additional employees, including family members. These firms earn a

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[4] Exchange rate used: 10 Mexican pesos equals 1 U.S. dollar

[5] Financial data were obtained from the *FY 1999 Microenterprise Implementation Grant Application* presented to USAID by ACCION International on December 7, 1998, in addition to information obtained during the country team's visit to ADMIC.

maximum of $4,000 from annual sales. Within this group, ADMIC grants loans to individuals based on their payment capacity and their ability to produce a guarantor. Loan amounts vary between $500 and $4,000, and carry terms of up to 36 months. Third, extended accumulation microenterprises, which are also considered to be urban and sub-urban economic units. Loans given to these microenterprises are considered "traditional" credit, and they are provided under the lending methodology previously utilized under the NAFIN program. This group of clients has the possibility of accessing loans from the formal banking sector. The size of loan amounts available vary from $4,000 to $8,000. No loans have been granted to this category under the new microlending approach.

One notable aspect about ADMIC is that it has received financial support—totaling about $400,000 in capital investment—from numerous private-sector enterprises in the City of Monterrey. Additional funding has come from matching government funds and minor grants received from other sources. Just recently, ADMIC obtained the equivalent of $500,000 in capital from an enterprise pertaining to a group managed by ADMIC's president. ADMIC has been given indications that the size of this latter grant may be doubled in the future should ADMIC manage the initial capital infusion in a satisfactory manner.

During the operational years of the NAFIN program, ADMIC's administrative costs were covered by interest income and fees paid by NAFIN for portfolio administration. This arrangement allowed ADMIC to use many of the grants it had received over the years for capitalization. This strategy permitted ADMIC to accumulate a net worth equivalent to $2.5 million, which was eventually used to purchase the NAFIN portfolio. At present, however, ADMIC must cover all of its operating costs, as well as generate enough profits to grow, independent from outside sources. Thus, cost controls will be of paramount importance in determining the success of ADMIC in the near future.

A new, computerized loan information system is being installed at ADMIC. This system will allow the institution to better monitor its microcredit loan portfolio. Once the loan system becomes operational in all of its branches, a similarly advanced accounting system will have to be developed and integrated with existing applications.

Under Accion's advice, ADMIC is using a new financial projection model developed by CGAP[6] called MicroFin. This model has enabled ADMIC to estimate future growth. Initial calculations show that ADMIC should have about $2.6 million dollars in net loans outstanding in five year's time, with a capital base of $2.0 million and an accumulated profit of $1.2 million. The accumulated loan loss reserve will reach $339,000. By the end of the five-year period, ADMIC estimates that it will have 6,044 active loans, of which 4,652 will be for solidarity groups and 1,392 for individuals. ADMIC sought a $3.0 million prime grant from the Mission in FY 1999, presented through Accion, in an attempt to boost capitalization and thus bring about faster growth. USID/Mexicodid not approve the grantas ADMIC has only recently commenced microlending operations. Accion has provided technical assistance to ADMIC for the past year to assist in developing ADMIC's microlending operations. ADMIC will likely leverage the benefits of Accion's assistance and re-apply for prime funding from the Mission in FY 2000.

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[6] CGAP: Consultative Group to Assist the Poor of the World Bank.

As a civil association outside of the regulated financial sector, ADMIC does not have access to credit information provided by public or private credit bureaus. Its lending analysis relies entirely on information provided by members of solidarity groups and though research conducted by field advisors (*promotores*) who track individual and group activities closely.

During the visit of the Country Team, the Director General of ADMIC stated that the auditors who prepared the institution's 1998 financial statements were calculating the effects of inflation on ADMIC's capital base for the very first time. However, financial projections available at the time of the visit still did not show the capital reduction impact resulting from the application of Mexico's 13 perent per year inflation rate.

Based on the above analysis of ADMIC's operations and projections, and in light of the financial support provided by private-sector entrepreneurs conforming ADMIC's Monterrey-based board of directors, USAID/Mexico views ADMIC as an important potential counterpart under the proposed strategy. The Mission will rely upon PRIME funding to boost the institution's capital, which should lead to an enhanced growth rate. PRIME would also fund continued delivery of technical assistance from Accion.

Asociación Mexicana de Uniones de Crédito del Sector Social, A.C. (AMUCSS).[7] AMUCSS was organized in 1992 as a civil association with a variable capital base. The association is a network of rural credit unions with the objective of providing representation, technical assistance, training, institutional diagnosis, and technological development to its members. AMUCSS[8] modified its bylaws in 1995 to extend its capacity to obtain and provide credit. It has 32 rural credit union members in 20 states, which in turn maintain more than 17,000 individual and "moral"[9] members.

Since its foundation, AMUCSS has worked primarily with financial organizations dedicated to assisting peasants in areas dependent upon commercial and subsistence agriculture.[10] A research paper prepared to the First National Forum on Cooperative and Solidarity Financing[11] contained information on 19 of the 32 credit unions affiliated with AMUCSS. According to this report, the outstanding loan balance of these 19 institutions was $31.8 million, of which $13.3 million, or 42%, was past due.[12] Furthermore, none of the 19 credit unions maintain loan loss reserves. The combined capital base of the 19 FIs equaled $4.0 million and savings under management totaled $701,000. In addition, these institutions maintained an accumulative loss of $2.3 million.

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[7] In English, AMUCCS stands for the Mexican Association of Social Sector Credit Unions.

[8] Data obtained from *Las Uniones de Crédito Campesinas en México* and from *Perfil Institucional* published by AMUCSS.

[9] A "moral" member is an institution, organization, society, or association, either public or private, with a legal capacity to operate.

[10] Credit Unions were first recognized as non-bank auxiliary credit institutions within the financial system in 1932. They are formed as private stock corporations under commercial law and their operations are regulated by both the SHCP and the CNBV. In reality, credit unions operate under the principles used by cooperatives.

[11] Zuvire Lucas, Martín, et.al., "1er Foro Nacional sobre Financiamiento Cooperativo y Solidario. Perfil Básico de las Organizaciones Populares en México,"September, 1998.

[12] Another study prepared for AMUCSS, entitled "Analisis Financiero General. Las Uniones de Crédito en México. 1989-1997," also reports that 40 percent of the loan portfolio is past due, representing 27.5 percent of total assets.

In order to improve its practices, AMUCSS management staff has also visited other Latin American, Asian, European, and North American rural financial institutions. In Mexico it maintins close relationships with numerous indigenous rural financial organizations, such as savings and credit cooperatives, savings and credit societies, credit unions, insurance funds, and NGOs. AMUCSS has maintained solid working relations with the GOM, especially with the Secretariat of Agriculture, the Secretariat of Finance and Public Debt, the National Commission for Banking and Securities, BANRURAL, Fideicomisos Instituidos en Relación a la Agricultura (FIRA), NAFIN. AMUCSS has also received technical cooperation from the Research and Rural Development Methodology Institute (IRAM) of France.

From a financial viewpoint, AMUCSS is a small organization mostly supported by fees from technical services and dues from members. Its total asset base as of December, 1998, equaled $60,420, and it maintained a negative net worth equivalent to $2,484.

In addition to its other roles, AMUCSS has been involved in efforts to promote amendments to the financial legal framework. AMUCSS has been active in the National Association of Social Sector Financial Organisms (*Coordinadora Nacional de Organismos Financieros del Sector Social*), which was organized in September, 1998, to analyze the legal framework of non-bank social entities. . Additionally, AMUCSS has also been involved in organizing the Mexican Institute of Rural Finance, established to create and strengthen local capacities, conduct applied research, develop innovative methodologies promote favorable national policies, and to promote a grading, auditing and inspection agency. Furthermore, AMUCSS is spearheading a project to organize "peasant banks" in marginal zones. At present AMUCSS is searching for funds and technical assistance to support these efforts.

Even though AMUCSS may become a strategic partner with USAID/Mexico to assist in efforts to promote regulatory refomr, its member credit unions are technically bankrupt. In addition, AMUCSS's principal objective is to provide agricultural credit, which is distinct from rural microenterprise credit. However, given that credit unions are allowed to capture savings and subsequently channel these funds in the form of loans to members, AMUCSS may in the future be able to serve as a conduit of technical assistance for associated credit unions interested in providing financial services to rural microenterprieses.

Centro de Apoyo al Microempresario, I.A.P. (CAME).[13] CAME is a Mexican non-profit institution that was established in the Valley of Chalco, on the outskirts of Mexico City, in 1993 from funding provided by Los Emprendedores Foundation, I.A.P. CAME's mission is to promote income-generating opportunities among the poor through savings, credit, and productive activities. CAME's promotes family microenterprises, employment opportunties, self-sustaing income-generating groups (GGIs), and financial accumulation groups (GAFs). CAME's basic financial methodology mirrors that used by community banks, in that it works with groups formed by an average of 25 persons. These groups, composed mainly of women, save for four weeks prior to receiving external financing, appoint their own directors, approve internal regulations, and receive necessary training from CAME staff. Once the group is deemed creditworthy, they are eligible to receive direct financing from CAME for up to 12 times the amount of funds held in savings. Loan re-payments to CAME are made in 16 weekly

[13] The English translation for CAME is the Center for Assistance to Microenterprises.

installments. Internal savings are used by the groups to grant sub-loans to their own internal members, usually at higher rates of interests than those applied to the prime loan received from CAME.

As of April, 1999, CAME had 6,086 active clients, organized into 275 groups. This total is down from a total of 13,036 clients originally participating in the program. Since its inception, CAME has granted 41,174 loans totaling $4.5 million. The outstanding loan portfolio is $488,000. CAME reports that it has a perfect repayment rate; however, no information detailing delinquency rates is available. Savings accumulated in GGIs equal $983,000. The average size of sub-loans is $158 and the average amount of savings per member is $171. The average interest rate paid on sub-loans is 5.5 percent per month.

CAME's was 87.44 percent self-sufficient as of the first quarter of 1999. The Director of CAME expects the organization to be fully self-sufficient within another year.

As an organization laying outside of the regulated financial sector, CAME does not have access to credit information provided by public or private credit bureaus. Its lending analysis relies entirely on information provided by GGIs.

CAME is a potential partner, as it is a member of Pro-Desarrollo. CAME could thus serve as a useful partner in the effort to increase GOM support to microenterprises.

Ahorro y Microcrédito Santa Fé de Guanajuato, A.C. (SFG).[14] SFG was organized by a group of prominent private businessmen in the city of León in 1996. It was sponsored by the State System of Development Finance (SEFIDE); during the initial years of operation SFG operated out of SEFIDE's office. SFG now claims to operate without state-provided financial support. However, SFG's offices, personnel. and administrative and accounting procedures still operate under SEFIDE's name, and SEFIDE is providing SFG with all necessary financial and technical assistance resources. To fully understand SFG's structure, both SFG and SEFIDE must be evaluated.

SEFIDE uses two financial and technical assistance tools to promote development in Guanajuato. The first such instrument is called Guanajuato Funds. Guanajuato Funds is a state government fund that provides financing in the form of grants and subsidized loans to state-promoted programs, including SFG, SINCA,[15] and "Cajas Populares." The second tool is a training and technical assistance program made available to NGOs, savings and credit cooperatives (*Cajas Populares*), SFG, and SINCA. The foundation of SINCA is being made possible as a result of funding provided by SEFIDE, NAFIN, private businessmen, and the Multilateral Investment Fund (MIF) . These four groups are providing financing in the amount of $3.0 million, $2.3 million, $2.7 million, and $4.0 million, respectively. . SINCA will promote equity and quasi-equity investments for small business (not microenterprises) in the state of

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[14] The English translation of SFG is Savings and Microcredit Santa Fe de Guanajuato. Very little hard data was available from SEFIDE-Santa Fé. In addition, the project meets with skepticsm in some quarters, because the ex-Governor of Guanajuato is now a candidate for the Presidency. Some feel that Santa Fé and the ex- Governor's political ambitions cannot easily be separated.
[15] SINCA: Sociedad de Inversión de Capital.

Guanajuato. SEFIDE intends to transfer management of the above programs to civil society organizations within the following year.

SFG's microenterprise lending methodology is based on the community bank model. SFG calls its groups solidarity nucleus. A nucleus is formed by first preparing a diagnosis of the zone in which it will operate, then promoting the idea of the nucleus among potential members. Subsequently, an organizational meeting is held and the policies, rules, and procedures for the nucleus are approved; the first directors are elected; socio-economic data are gathered from members; investment projects are discussed; and initial savings are deposited. This commencement stage lasts approximately five weeks. At the end of this period, credit in the amount of $50 for each borrower is granted, with a term of 12 weeks. During the second 12-weeks period, members continue saving and repay their loans regularly according to their individual commitments. Additionally, members receive training and technical assistance from their SFG advisor. After the initial loan is paid in full, incremental loans are granted in the following amounts, with their respective terms: for up to $80, for a period not to exceed 15 weeks for up to $150, for a period not to exceed 20 weeks; for up to $280, for a period not to exceed 28 weeks; and for up to $500, for a period not to exceed 40 weeks.

Nuclei are formed mostly by women—on average, in groups of15-20—who provide guarantees for one another, evaluate individual investment projects, receive training, and receive and provide technical advise. SFG has not yet graduated any of its client members beyond a fifth yet. However, management claims that if clients finishing a fifth cycle require additional credit, such nuclei will be referred to "Cajas Populares," or to another funding facility being developed by SEFIDE called "Multipréstamos."

Allegedly, SFG has about 25,000 members, with a delinquency rate of 6 percent[16] on the outstanding loan portfolio balance. However, SFG maintains no figures to substantiate these claims.

SFG management notes that their model is already being replicated in four otherlocations: Santa Fé de Colima, San Luis Potosí, Jalisco, and Queretaro.[17].

In addition to direct assistance provided by SEFIDE, SFG has been receiving assistance from the Anahuac Institute for Alternative Development Finance (IAFAD), supported by SEFIDE, to expand and replicate its microfinance model. SFG is also receiving technical assistance from the Canadian Cooperative Movement Desjardins. This technical assistance package is also being financed by SEFIDE.

SFG is another potential partner for USAID, but only upon the completion of an in-depth institutional and financial analysis. Its community-banking model, supported by prominent, socially-oriented businessmen, may in fact be replicable provided that the transparency of SFG's operations is enhanced.

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[16] The formula used by SFG for determining delicuency rates is dividing past due installments by the outstanding loan portfolio

[17] The validity of these claims was not verified.

Asociación Programa Compartamos, I.A.P. Oportunidades Financieras.[18] Compartamos was organized in 1985 as an outgrowth of a previous NGO called "Gente Nueva" with funds from PL 416. In 1990 Compartamos become a private assistance institution under a special IAP law.[19] Under this law, Compartamos could not fund its activities with loans, but rather only through donations and capital market activities.[20] Since this time, Compartamos has received capital donations from CGAP, the IDB, Fomento Social Banamex, Nacional Monte de Piedad, Groups Cemex and Pulsar, the Government of the State of Oaxaca, and several other private donors.

The inability to obtain loans and capture savings severely restricted Compartamos's ability to grow. Therefore, Compartamos is now in the process of transforming from an AC to a regulated SOFOL . Compartamos will invest $2.0 million (40 percent of the total investment required), or an amount equivalent to the sum of its retained earnings, into creating this new organization. Other initial partners will include: the Gate Way Fund (20%); and Pro-Fund, the Andean Promotion Corporation (CAF), the Inter-American Finance Corporation (IFC), and others (40%). During its conversations with the country team, Compartamos indicated an expectation to receive an operating license sometime in 1999.

Between 1990 and 1993 Compartamos launched and subsequently strengthened its microenterprise lending program, using the individual and solidarity group methodologies developed by Accion International. Compartamos operates in urban and rural zones in Oaxaca and Chiapas. Most of its clients are women traders (70%), followed by manufacturing enterprises (20%), and service-oriented firms (10%). Compartamos does not make loans to agricultural producers.

The average loan balance per member is approximately $60, with an average disbursement of $130 per member. As of December, 1998, Compartamos had 43,401 active clients, with a loan portfolio totaling $2.9 million. The delinquency rate (measured by the risk or total contaminated portfolio) was 3.38 percent for loans delinquent by up to 30 days, and 0.81 percent for loans delinquent by up to 90 days. The loss rate during the latest fiscal year was 1.15 percent of the total loan portfolio.[21]

Compartamos reached a state of self-sufficiency in 1998. By that time it was able to accumulate about $3.4 million in net worth, out of which $2.2 million are retained earnings accumulated during previous fiscal years. Compartamos has 116 credit officers, each of which manages an average portfolio of 350 clients.[22]

Compartamos is not interested in promoting regulatory reform or changing existing legislation that limits the growth of the microfinance sector. Management is completely focused on organizing a SOFOL. Compartamos is a founding member of Pro-Desarrollo, but is not likely to

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[18] The full translation of Compartamos's corporate name is The "Let's Share" Program.
[19] This law is being revised at present in Congress in order to strengthen oversight of credit-providing organizations.
[20] In spite of this legal restricction, Compartamos holds one long-term subsidized loan totaling approximately $500,000, received through the IDB's Small Projects Program.
[21] Information obtained from an interview with the Director General and a Fact Sheet current as of May 5, 1999.
[22] Although this average is considered adequate by international standards, there are microfinance institutions that have reached 500 or more clients per credit officer in Latin America.

be an active partner in the near future as it does not require capital, training, or technical assistance other than that being provided by Accion International.

Invertir Para la Sustentabilidad, A.C.[23] Invertir is a recently formed non-profit financial and technical assistance association. The association promotes co-investments between the social and business sectors to strengthen self-governance, in addition to innovative, profitable, and sustainable economic activities. Invertir was organized under the sponsorship of the InterAmerican Foundation (IAF). The institution sees itself as an international organization integrating human, material, and financial resources from different countries reflected in its general meeting composed of representatives from the development community of the United States, Mexico, Canada, France and England. Invertir has signed several cooperative agreements with environment support foundations, such as the Resource Foundation and the Synergies Institute. Invertir also receives support from the Holland Technical Cooperation Agency ($800,000) to strengthen institutional capacity, and the IDB ($500,000) for productive purposes.

Invertir works with existing peasant organizations which have the capacity to carry out business activities. Invertir promotes innovative financial systems and technical assistance, and works to develop regional market niches for organic produce. Specifically, the association helps select investment projects, perform preliminary evaluations, search for financing, conduct follow-up work, provide technical assistance, and perform ex post evaluations. It sponsors forums and seminars to encourage business relations and investments between peasant organizations and the business community.

Invertir is now working with several peasant and indigenous organizations, including: ANEC, CEPCO, COOPCAFE, ERA-USACHI, RED MOCAF, ISMAN-CAFSA, RASA, SANZEKAN, SEDAC, UNIÓN, and UCIRI. The first nine of these organizations are active in 2,703 rural Mexican communities, have more than 100,000 members, and cultivate or produce more than 337,000 hectares of basic grains, coffee, corn, wood, ginger, and artisan products.[24] The most important needs of these institutions is improved business capacity, uniform and standardized quality of production, location of organic market niches in the U.S., and understanding business organization and finance.

Invertir is negotiating with the MIF to receive a grant of $2.5 million to be disbursed over the course of three years in order to strengthen and help three associations produce and market ginger, palm, and organic coal. Upon receipt of funding, the associations will organize a self-sustaining marketing enterprise based in the U.S.

To date, Invertir has developed nine investments profiles together valued at about $9.0 million. Profiles have been developed to provide investments in credit and administrative support resources, the marketing of eco-turism, and the production and marketing of organic coffee,

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[23] The English translation of Invertir's full company name is Investing for Sustainability.
[24] Data obtained from interviews and documentation provided by Invertir, including: "1er Encuentro para la Conformación de Estándares Nacionales para Mercados Alternativos y Sustentables en México," March, 1998, and "Carpeta con Perfiles de Inversión and Invertir Institutional Profile."

cacao, and ginger. Additionally, one profile has been developed with the view of creating and supporting village banks to be assisted by AMUCSS.

Invertir is a potential partner of USAID/Mexico for the Missions activities designed to protect the environment, to increase marketing opportunities in the U.S. for Mexican microenterprises, to maintain and increase employment in rural areas, and to strengthen grassroots democratic institutions. However, an in-depth institutional and financial analysis must be carried out before any commitments are made.

Pro-Desarrollo, Finanzas y Microempresa.[25] Starting in 1992, six private, non-profit organizations met periodically to exchange opinions concerning their work with the economically disadvantaged populations. This discussion group was called The Employment Table. The Employment Table identified three key problems hindering economic growth: the legal and fiscal framework, staff training, and financing.[26]

In 1993, The Employment Table organized a seminar to discuss the existing legal and fiscal framework. The seminar was called "The Other Productivity" and its conclusions and recommendations were published in 1994 in a book called *La Otra Productividad. Promoción y Obstáculos Jurídicos para la Autogestión y el Empleo.* Another publication produced as a result of this seminar was entitled *Finanzas y Productividad Popular*. The seminar and the two publications were sponsored and financed through grants provided by the Ford Foundation.

In 1997, with the support of the SEEP Network[27] and the Ford Foundation, Pro-Desarrollo was founded with 13 member organizations, one associated institution, and four individuals. Later, one additional organization was incorporated. Member organizations include: ADMIC Nacional, A.C.; AMUCSS, A.C.; CAME, I.A.P.; FinComun, S.A. de C.V.; Fundación Mexicana para el Desarrollo Rural, A.C.; Fundación los Emprendedores; and Asociación Programa Compartamos, I.A.P., among others. The Ibero-American University is an associated member.

Pro-Desarrollo is financed by member dues, as well as from donations provided by organizations like the Ford Foundation. To date, Pro-Desarrollo has not received official authorization to operate; therefore, it is functioning under the auspices of Fundación Los Emprendedores's legal authorization.

Pro-Desarrollo's mission is to strengthen the capacity of member organizations to provide innovative financial and non-financial services, carry out joint research on the microfinance sector, train its members, and influence public policy. Its main objectives are to help create an adequate framework for its members to carry out their activities, synthesize and disseminate experiences, train practitioners, provide a forum to exchange information, and represent its members with the GOM.

Pro-Desarrollo maintains three administrative units: a directorate, a technical coordination group, and an operative coordination unit. The directorate meets monthly. These three units

[25] The full English name of Pro-Desarrollo is Pro-Development, Finance, and Microenterprise.
[26] Data obtained, extracted, and translated from *Pro-Desarrollo, Finanzas y Microempresa. La Nueva Productividad.*
[27] SEEP Network: The Small Enterprise Education and Promotion Network

support the establishment and operations of distinct workgroups Originally, three work groups were formed: the Inter-American Microenterprise Forum; an institutional development workgroup; and a human resources workgroup. Later, Pro-Desarrollo formed a forth workgroup related to legal and fiscal framework issues.

Pro-Desarrollo is a potential USAID/Mexico partner. The organization has established itself as a recognized meeting ground for the most important organizations dealing with microfinance and microenterprises in Mexico. Pro-Desarrollo is the best-positioned organization to mobilize other for development of the target sector. An in-depth institutional analysis should be carried out in order to determine it's the organization's sustainability.

Universidad Ibero-Americana (UIA); Department of Economics. A principal objective of the UIA's Department of Economics is to elaborate and propose public policies that promote more prosperous and equitable economic and social development. Consistent with this objective, the Department of Economics, together with the Department of Administration, is working on a diagnosis of the principal problems affecting the microenterprise sector and to what extent public policies are adequate to resolve those problems.[28] The research seeks to better understand the role microenterprises are playing in Mexico, and whether they influence the employment structure or income distribution. Additionally, the UIA seeks to better understand the legal limitations that constrain the growth of the sector. The research to be carried out will cover three areas: understanding the financial structure of microfinance institutions; microenterprise financing needs; and public policies needed to remove obstacles that stymie the growth of the microfinance sector.

An additional area research is the linkage between microenterprises and environmental protection. The UIA has an Environment Department that is looking for ways to incorporate a "green" perspective into the University's microenterprise research.

The results of the research are to be included in a book, which will be published and widely disseminated. The dissemination process will aim at increasing public awareness of the problems, limitations, and proposed solutions for microfinance.

The UIA is a potential partner of USAID/Mexico. The University has a sound reputation in Mexico, and it may provide an independent base for research that supports USAID objectives.

Patronato del Ahorro Nacional (PAHNAL).[29] PAHNAL is a decentralized government organization that promotes popular savings in Mexico via small savings and time-deposit accounts. The central government has historically subsidized PAHNAL operations; however, this year—for the first time in 40 years—PAHNAL did not withdraw funds from the national budget. PAHNAL was able to cover all operational expenses out of the margin made between

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[28] Information was obtained from interviews held with the Head of the Department of Economics and his collaborators, and from articles written by Pablo Cotler ("Algunas Reflexiones en torno a la Microempresa") and by Pilar Campos and Pablo Cotler ("El Estado Actual y Las Perspectivas de las Microfinancieras en México," propuesta de investigación presentada a la Fundación Ford, May 17, 1999.

[29] The English translation of PAHNAL is the National Savings Protectorate. Information provided was obtained from interviews with the Director General. No written material was available.

the cost of client savings and income generated from investments in government bonds and commercial bank accounts.

According to its statutes, PAHNAL's main objective is to capture savings. Seventy percent of all savings assets must be securely invested in GOM-issued treasury bonds (CETES), or deposited with NAFIN or the Bank of Mexico. The remaining 30 percent may be deposited in the top five AAA-Arated (for local debt in Pesos) commercial banks in Mexico.

PAHNAL has been able to capture about U.S.$125 million via 670,000 saving accounts. PAHNAL operates approximately 500 outlets located in post offices and rented spaces. Of these outlets, 300 are located in urban areas' the remaining 200 are located in rural towns of 20,000 to 25,000 inhabitants. PAHNAL expects to open 1,000 more outlets in 1999 and a similar number in 2000. The average size of savings account ranges between U.S.$35 and U.S.$40, with most accounts holding between U.S.$5 and U.S.$200. Accounts typically belong to housewives (33%), public servants (18%), private depositors (12%), and microentrepreneurs (12%). Of total deposits, 74 percent are deposited in savings accounts and 26 percent are held as time deposits. Based upon average monthly balances, funds held in savings accounts gain an annual return of between 6 percent and 11 percent, while time deposits maintain interest rates between 10 percent and 11.3 percnet. The objective of PAHNAL is to pay depositors interest on deposits at least equal to the rate of inflation .

In meetings held with the Country Team, the General Director of PAHNAL expressed interest in developing a method for channeling part of its funds directly to the productive sector, if a mechanism could be arranged to protect savers from any possible losses. Since it has already received authorization from its board to deposit up to 30 percent of savings (about U.S.$37 million) in triple-A rated commercial banks, part or all of these funds could possibly be channeled directly to other FIs for use as capitalization. A DAC guarantee mechanism could potentially be used to guarantee such an operation, to alleviate the risk posed by on-lending these funds to other FIs.

Fundación Mexicana para el Desarrollo Rural, A.C. (FMDR).[30] A group of private businessmen created the FMDR in 1969 based upon previous experiences with a peasant guarantee group to access credit from formal sources and the establishment of development centers. The foundation is a private, non-profit, apolitical, and non-religious institution supported by the Mexican private sector. FMDR's main objective is to promote the development of small-scale, low-income peasant families through the associated development centers.[31] FMDR's development work is based on based on five principles: respect of the dignity and freedom of the human being; solidarity; subsidiary support; efficacy and efficiency; and respect for natural resources. The FMDR operates through associated development centers, which in turn provide assistance and training to rural cooperatives. This three-level structure (FMDR, development centers, and rural cooperatives) is called the Foundation Movement.

[30] FMDR in English stands for the Mexican Foundation for Rural Development.

[31] Other Associated Foundations or Centrals promoted by FMDR. There are now around 33 Centrals in 24 States.

The basic development unit of the FMDR is the "famiempresa"[32] "Famiempresas" are encouraged to form rural cooperatives to receive information on clients and providers, to strengthen relations with enterprises willing to establish contractual links, and to form strategic alliances with clients and providers. To achieve its objectives the FMDR provides training regarding project design, procurement of human, financial and material resources, and administration of projects under implementation. In 1998, the foundation assisted 1,275 rural cooperatives, indirectly benefiting 13,354 associated "famiempresas."[33]

During the course of 1998, the foundation's credit department obtained funding from four commercial banks (among them BITAL, Banco del Bagío, and BANORTE), in addition to the Trust Funds Instituted in Relation to Agriculture (FIRA). The FMDR obtains credit from banks and provides it to cooperatives with the guarantee of the development centers. In addition to dealing with banks and FIRA, the Foundation operates a small project financed by the IDB. The total value of funds in the FDMR system at present is $14.5 million, with credit received by "famiempresas" equaling $10.6 million. The foundation reports no delinquency with regard to repayment of bank funds at present; the lowest recovery rate experienced was 95.34 percent. Interestingly enough, since an A.C. is not allowed to grant credits the FMDR is handling its credit operation entirely as contingent accounts (off the balance).

The FDMR system formally employs has 249 and counts on the assistance of an additional 404 volunteer directors. Due to the size of its operations, FMDR is a potential USAID/Mexico partner. However, FMDR is presently in a precarious financial state. Their credit operation needs an in-depth review, as do its rural cooperatives, Prior to making any commitments with FMDR, the Mission would need to conduct an in-depth review of the foundation's credit practices as well as the operations of associated rural cooperatives.

Instituto Anahuac para el Financiamiento Alternativo del Desarrollo (IAFAD).[34] In 1990 the University of Anáhuac del Sur launched a project to provide training and technical assistance to microenterprise practitioners in response to requests for such services received from the microfinance community. The project become formalized as IAFAD in 1994. The institute has entered into strategic alliances with Compartamos, Generación Empresarial Mexicana, Santa Fé de Guanajuato, and Fincomún, among others.

The institute focuses on the following activities: training, information dissemination, case study development and preparation, applied research, public policy, cooperation, and technical assistance.

IAFAD and COLCAMI are operating under the same leadership and share the same office at the University of Anahuac del Sur in Mexico City.

Consorcio Latinoamericano para Capacitación en Microfinanciamiento (COLCAMI).[35] In 1997, the IDB invited selected Latin American institutions dealing with microfinance to present

[32] "Famiempresa" translates as family production unit.
[33] Family enterprises.
[34] In English IAFAD stands for the Anahuac Institue for Alternative Devlepment Finance.
[35] The English translation of COLCAMI is the Latin American Consortium for Microfinance Training.

proposals to create a regional microfinance training center. Mexico City's Anáhuac del Sur University was selected, allowing the university to found COLCAMIin 1998 with the assistance of a one-time grant contribution of $1.8 million from the IDB.[36] One of the principal objectives of this grant was to assist COLCAMI in becoming financially self-sufficient, which the organization has so far failed to become.

COLCAMI's mission is to strengthen the capacity of formal and informal financial institutions to provide sustainable, high-quality financial services to the Latin American region's microenterprises. To carry out this task, COLCAMI has created a specialized training center for use by microcredit finacial institutions. The center disseminates best practices in the realm of microfinance, and benefits from the technical and professional resources of institutions committed to Latin American regional development. COLCAMI's objective is to combat poverty by providing access for microenterprises to sustainable, non-subsidized credit.. Also, COLCAMI trains institutions interested in beginning microfinance operations.

COLAMI members include the IDB, Banco Sol and Caja de los Andes in Bolivia, Compartamos in Mexico, Fenacoac in Guatemala ,and Bandesarrollo in Chile. These institutions form an institutional "umbrella" that provides technical and professional resources for COLAMI's training programs.

To increase worker productivity, COLCAMI trains professionals via an integrated and continuos process. COLAMI aims to enhance the professionalism of microfinance institutions by solidifying MFI personnel's knowledge of their work, channeling institutional human and financial resources to improve overall levels of competence, diminish high staff turnover rates in the field, and increase worker productivity.

COLCAMI offers courses in each country and sub-region in Latin America upon demand. Coursework is designed to transmit best practices in the field and are adapted to the specific needs and interests in each country or sub-region. In 1999, courses will be offered in Costa Rica, Guatemala, El Salvador, Honduras, and Brazil, in addition to those offered in Mexico.

Courses in Mexico include basic, two-week courses , two-day modular courses , and one-week specialized seminars. COLCAMI's 1999 Mexico includes coursework covering the following themes: principles, experiences and best practices for microfinance programs' organization and administration of human resources; evaluation and elaboration of microfinance programs; leadership and effectiveness for credit officers; strategic planning with emphasis in growth and finance; project administration for institutional strengthening; loan portfolio administration and delinquency control; design of financial products' and advanced treasury administration.

Initially, COLCAMI was also founded to train microentrepreneurs, but the high cost of the institution's courses have prevented many microentrepreneurs from attending.

Both, IAFAD and COLCAMI are potential partners as support institutions of the microfinance sector. As partners, USAID would assist COLCAMI in designing cost-effective microenterprise courses and also develop a curriculum suited for Mexican micro-finance institutions.

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[36] Information was obtained from interviews and documentation provided by COLCAMI.

Centro Méxicano para la Producción Más Limpia (CMP+L).[37] CMP+L was established in December, 1995, as part of the United Nations Industrial Development Project and the United Nations Environment Project. These two organizations have joined efforts to introduce the concept of cleaner industrial production in developing countries. CMP+L is co-financed by the Instituto Politécnico Nacional of Mexico and USAID, under the latter's clean energey strategic objective.

CMP+L has developed relevant case studies for zinc, chrome, and copper plating, anodizing aluminum, and iron and steel foundry processes in small- and medium-scale private companies. CMP+L is publishing the results of its research and providing training to interested companies.

CMP+L , as part of its strategy to become self-sustaining, is looking for financing from the banking sector and donor community. However, the General Director indicated that CMP+L is not engaged in developing "bankable" projects (projects that are able to receive and support bank financing).

The General Director expressed interest in the idea of using existing microfinance channels to disseminate environment-friendly activities among microfinance borrowers.

The Mexican Federation of Private Health and Community Development Associations - (FEMAP) Working through 8,000 female promoters of health services -FEMAP, implements 22 programs in 16 states covering 20 cities and 251 rural areas. FEMAP's community development activities have centered on improving the health of poor women through income-generating activities. Vocation training is provided with the result that those involved are able to work from home.

FEMAP is now interested in stemming emigration from the communities that they serve and in increasing family incomes through ecoenterprises (composting, tree nurseries, and recycling; besides other alternative income schemes. To that end, FEMAP is interested in designing a strategy and a business plan to implement a microenterprise development program, including microcredit schemes where there are no local specialized microfinance institutions. FEMAP wishes also to develop the capability to implement the program and to present funding proposals to donors.

The IBRD's Rural Development in Rural Areas Project, implemented through the Secretariat for Agriculture, Livestock and Rural Development (SAGAR), will provide assistance in 6 regions of the states of Oaxaca, Hidalgo, Veracruz and San Luis Potosi during its first phase. FEMAP may work with the IBRD since, of those states, FEMAP works in 4 rural communities in Oaxaca and 9 in Veracruz.

The Mission will assist FEMAP to design individual strategies to develop microenterprise activities that support conservation, to assist them to prepare a schematic program, and to train them in preparing and presenting winning funding proposals..

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[37] The English translation of CPM+L's name is the Mexican Center for Cleaner Production.

USAID is considering using existing DA funded contracts with consulting firms, particularly Winrock, to identify and design pilot microenterprise activities with FEMAP in rural areas and/or in activities related to recycling and/or conservation and energy savings. Also, in preparing funding proposals and in designing a microenterprise/ecoenterprise development and finance training program for the 22 federated programs. In particular, energy saving schemes and alternate use of renewable power will be explored.

Pronatura Yucatán Foundation. Pronatura Yucatán was established as an autonomous foundation by the National Chapter of Pronatura, which in turn was established by the World Wildlife Federation.

Pronatura Yucatán has been able to obtain financial support from the business community in Yucatán

Pronatura Yucatán works to protect endangered areas and their habitat. It also protectcs endangered species. As part of that mission, Pronatura Yucatán has become involved in community development programs to help provide environmentally-friendly income alternatives to the population in and around endangered and protected areas.

The Mission will support Pronatura Yucatán to develop a community development strategy and design a microenterprise development and credit program, as part of its community development work, which is part of its conservation strategy. Ideally, practical, sustainable uses of renewable energy will be explored.

Since the population near the Kalakmul Reserve in Yucatán is composed almost exclusively from internal migrants who lived outside of Yucatan, Pronatura Yucatán is researching the causes and effects of internal migration in order to design an environment-friendly community development strategy. Similarly, the population of Celestún in Yucatán, next to the Flamingo protected estuary, is composed of first and second generation migrants and Pronatura Yucatan is conducting a similar research.

USAID has provided D.A. funds to Pronatura Yucatán for conservation and institutional strengthening, either directly or through Pronatura National.

Pronatura Yucatan needs funding to start a pilot blue crab aquaculture program in Celestun that, if succesful, will be turned over to the community as a more permanent alternative income to overfishing and emigration. As part of that, if would be interesting to determine if solar power can be used for pumping the estuary water for the crab cultivation tanks.Pronatura Yucatan also needs funds, training and technical assistance to develop its embryonic microenterprise program in the communities surrounding the Kalakmul national reserve. Pronatura has started an organic honey program that has already involved 5% of the total population of about 20,000 and is also starting backyard animal husbandry program. Pronatura Yucatan plans to organize a fruit trees and forestry management program in the communities around Kalakmul. Renewable uses of energy may be introduced here also.

The National Chamber of the Transformation Industry (CANACINTRA). CANACINTRA, with 30,000 members of all sizes is the largest and most representative enterprise association in Mexico. CANACINTRA members are registered with Federal Tax Registry. It provides variaety of services to its membership including training, and human resource formation to affiliated and non affiliated members. CANACINTRA has 86 offices nationwide, including 6 in Mexico City.

CANACINTRA´s mission is to influence the productivity and ability to compete of industrial members.

The most important aspects of CANACINTRA´s training are: training courses are programed as a result of annual surveys; external advisors are drawn from a list evaluated annually; infraestructure (facilities and equipment) are available for training purposes; direct training courses costs are covered by participants, while indirect costs are subsidized by the Chamber of Industry; and its activities are nation wide.

As part of that activity, CANACINTRA has affiliation arrangement with the CMP+L, the Mexican Society for Norms and Certification -NORMEX, the Technology Transfer Unit, and with the Eurocenter Enterprise Cooperation. All these entities provide important business services, including certification required by the Mexican Government and by foreign buyers.

CANACINTRA also established with GTZ a technical training institute and operates programs in a sustainable manner. CANACINTRA, through the NORMEX certification institute can certify that shops meet established requirements for trained staff, equipment and procedures. NORMEX can also serve as a depository of data on specific repair standards and procedures that shops can tap into.

EcoSolar A.C. is an ecobusiness NGO established in 1983 which works in the design, promotion and implementaion of programs and proyects for the sustainable development of poor areas in México.

EcoSolar has designed and implemented various proyects since 1983, and has developed an expertise in environmental engineering.

The main areas of work for ecosolar are:

- Design, implementation and administration of sustainable development projects;
- Design and development of environmental engineering technology;
- Traing and transfer of environmental technology;
- Environmental education;
- Agroecology;
- Community enterprises;
- Ecotourism;
- Research and evaluation of ecological area management.

EcoSolar is experienced, well organized, has a clear vision which works for Global Climate Change, as well as more general microenterprise objectives. They are also garnering other important support (including from Citibank, Hewlett Packard and Dupont in Mexico).

Ecosolar is designing a new program: Bioplaneta, a market-oriented project, that will use training and follow-up with campesino producers as a key to long-term success. Bioplaneta will work with established universities such as the Tecnológico de Monterrey, which will provide their students to do the needs analyses.

EcoSolar's widespread activities have caused its operating expenses to increase to $300,000 a year, which seems reasonable given their scope, but raises concerns about its institutional viability.

Mexican Nature Conservation Fund, A.C. (FMCN). The FMCN is a conservation financial tool that provides medium and long term economic support to conservation initiatives, groups and research institutions. Additionally, it promotes strategic actions related to the environment in México. The FMCN dedicates all of its resources to the conservation of the biodiversity, leaving the support of other environmental activities to other specialized institutions.

The FMCN was founded in 1992 under the auspices of the World Wildlife Fund (WWF) and the GOM. The FMCN initial supporters were the Mac Arthur Foundation, the Packard Foundation, The U.S. Agency for International Development and Banker´s Trust. It received its charter in 1994.

The FMCN mission for the period 1998-2003 is to preserve biodiverity in México and to assure the sustainable use of natural resources in México by the promotion of strategic actions and medium and long term financial support.

In 1998, the FMCN supported 50 projects for an approximate amount of $17.0 million Mexican pesos in grant financing. The projects financed were aimed at the conservation of ecosystems and species, sustainable use of natural resources, institutional strengthening and environmental education, and strategic projects and emergencies. The total net worth of the foundation as of December 1998 was $480.1 million Mexican pesos.

FMCN is interested in participating in the USAID/México microenterprise strategy in those activities and areas that may contribute the achievement of its mission.

El Colegio de la Frontera Norte (COLEF). COLEF was legally constituted as the "Centro de Estudios Fronterizos del Norte de México in 1982. COLEF´s origin derives on the experiences at "El Colegio de México, and especially on that institution´s interest in the social aspects of the U.S. - Mexican relations. COLEF is located in Tijuana, Baja California.

COLEF institutional objectives are to advance scientific understanding of the social, economic, cultural, demographic, polital, urban, environmental, gender-related, and health processes gthat characterize The México - US Border Region, to transform this knowledge into tools applicable in the regional planning efforts and to identify and operationally define phenomena that could hinder the development of the border region, its integration into Mexico´s national development process, and relations between Mexico and the United States.

The graduates studies offered at the College include Demographic Studies, Regional Development, Applied Economics and Environmental Management, as well as the doctural program in Social Sciences. COLEF also offers programs in Human Rights and Linkage with the

Migrant Community, Japanese Studies, North American Studies, Ecoparque and the Geographic and Statistical Information System for the Northen Border.

COLEF has successfully established collaboration efforts with U.S. Universities including the Universities of Arizona, Texas at Austin and at El Paso, Southern California and the San Diego State University. It has also established relationships with Canadian and European Universities as well as with Mexican universities and academic institutions. Federal Mexican Agencies count also as strategic alliances such as the National Population Council (CONAPO). The Ford Foundation in México has also funded population studies in the past.

Researches carried out by the school include Labor Markets, and Small to Medium Scale Enterprises and Regional impacts of Nafta in México: A comparative Advantage Perspective, Change and Demographic Interactions in the U.S. Mexico Border Region: Families and Labor Markets, Growth, Instability, and Volatility: Women's Employment in Mexico's Norther Border Cities, Population projections for Mexico's Northern Border Sates: 1995-2025 and The Working Poor in the Restructured California Economy: An Etnographic Study of a mexican immigrant Barrio in San José.

COLEF is a well known an respected member of the academia in Mexico. The USAID Mission is considering the institution to carry out its migration study under its strategy.

Center for the Incubation of Enterprises (INCUBASK). The center was established by a joint effort of the Autonomous University of the State of México, the Development Mexican-Vasque Insitute, and the Government of the State of Mexico in 1996. Its mission was to become the facilitator agent to obtain resources for viable projects and existing enterprises. INCUBASK is located at Tecámac, including 22 municipalities in the State of México and 1 in Hidalgo. It owns a building of 2,500 square meters to house 25 enterprises, computer room, meeting rooms, cafeteria, e-mail and other services. It provides technical assistance (feasibility studies, business planning, business training, support in obtaining resources, and business conections).

As the name suggests, the center is aimed at organizing and supporting new ventures. Income generated by the services provided are not sufficient to cover its costs.

Technological and Economic Development Research Center (CIDEYT). CIDEyT is a project carried out by a group of businessman of Parral (Chihuahua) but it includes 22 municipalites of northen Chihuahua and Southern Durango. The initiative was a response to the mining crisis that affected this region a few years ago. The first step was to creat a school of international economy (EEI) within the Autonomous University of Chihuahua, with a practical focus since students work "in situ" at enterprises. Assistance range from preparing business plans to development tools and instruments to improve their competitive position. The second step was to carry out a diagnostic of the economic sectors of the region. The third step was the organization of CIDEyT to offer advisory services and training to enterprises with the support of students from EEI.

After having concluding this organization phase, CIDEyT provided assistance to 100 enterprises (90% of them micro and small enterprises). When technical assistance and training services cannot be provided by the center, assistance is provided through the Total Quality and Modernization Program (CIMO) of the Secretary of Labor and Social Security.

Based on the results obtained, the center desided to expand and requested support from the IDB/FOMIN. FOMIN will provide $1.4 million, enterprises $0.3 thousand (25%), the University $0.13 thousand (12%) and CIMO $.77 thousand (7%).

IDB has not evaluated this project so far, but the leasons learned have been quite interesting.

Under its strategy, the USAID/Mexico Mission will evaluate the experience and then will try to replicate with other training centers and universities in selected areas.

USAID/MEXICO MICROENTERPRISE STRATEGY
Results Framework Diagram

Strategic Objective
To Strengthen the institutional base for sustainable growth by supporting Mexican initiatives

Intermediate Result No 1
Increased communication and collaboration among ME finance and other service providers, to define constraints to ME growth, and organize Mexican initiatives

Sub IR 1.1
Mexican Objectives for strengthening the institutional foundations for microenterprise defined and action mechanisms developed

- Mexican Working Group Constituded
- Observational trips to other countries made by selected MWG members
- At least two workshop conducted on key issues constraining ME growth for MWG members
- MWG sets objectives, identifies priorities and creates plans to create a supportive environment for ME growth

Intermediate Result No.2
Selected ME finance institutions' management ability strengthened, to help increase and improve credit and financial services to microenterprises

Sub IR 2.1
Feasibility of creating a new credit bureau to serve the specialized needs of MFIs determined

- Pre-Feasibility study completed on creating a small, private credit bureau

Sub IR 2.2
Sustainable source(s) of capitalization accessed for microenterprise

- At least one source of readily accesible capital opened to parner MFIs for lending to microenterprise

Sub IR 2 3
MFIs institutional capacity strengthened, to increase microenterprise access to credit and financial services

- Financial services, training and t.a. provided in accordance to needs
- Policies and procedures to strengthen partner MFIs designed and implemented Cost-effective information systems in place for partner MFIs
- Cost-effective information system in place in partner MFIs
- Additional mechanisms for reducing transaction costs designed and tested with MFI partners

Intermediate Result No. 3
Increase understanding and appreciation of the role of microenterprise in the Mexican economy; the needs of MEs and their influence on decision making

Sub IR 3.1
Study of ME needs, priorities (above subsistance level) completed

Sub IR 3.2
Relationship analyzed between ME and the need to migrate. Results used to inform on possible revised targeting of resources

- Study of ME needs & Priorities completed
- Study of relationship between ME and migration in areas of high out-migration completed
- Based on studies findings, policy dialogue opened with GOM, other donors, NGOs, MGIs and appropriate AID offices concern ing future targeting of ME resources

Sub IR 3 3
Information base developed, to educate GOM policy makers and others on the contribution of ME to Mexico's economic growth;

- Study of actual and potential ME contribution to Mexico's economic growth and linkages completed
- Results disseminated and discussed with key GOM and other donor decision-makers

Intermediate Result No. 4
Models and mechanisms developed to meet the financial needs of rural microenterprise

- Survey of ME service providers in rural areas completed; and findings used to identify institutions able to expand their service outreach to rural microenterprise customers
- In-depth, empirical assessment of rural ME conducted in select USAID, other donor and NGO project areas
- Mechanisms developed and tested for delivering ME finance services tailored to conditions in selected rural areas