DEEPENING MALAWI'S MICROFINANCE SECTOR PROJECT (DMS) FY 2006 ANNUAL REPORT

OCTOBER 1, 2005 – SEPTEMBER 30, 2006

Smallholder Tea Growers Plucking Leaves in Mulanje, Malawi

October 31, 2006

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Abbreviations and Acronyms

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

I. EXECUTIVE SUMMARY

This is the second-year annual report for the Deepening Malawi's Microfinance Sector Project (DMS) implemented by Chemonics International (CI) contracted by USAID/Malawi under the financial service component of the Accelerated Microenterprise Advancement Project (AMAP) Indefinite Quantity Contract (IQC). The Task Order #804 for this project was signed in September 2004 with a ceiling amount of $3,477,056. This report covers the project activities undertaken during the period October 1, 2005 – September 30, 2006.

The overarching Results Framework objective that DMS will achieve is the deepening of Malawi's financial sector through expanding access to sustainable financial services for micro-enterprises and low-income households. It will do this through three project components:

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

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

Local project administrative capacities that were built over the first year provided excellent support for the increased technical activities undertaken in year two. All the field office support and professional staff positions present at the project start-up remained and the relationships they built with clients and suppliers proved increasingly productive over time. The large meeting room at the project's Lilongwe office was much used by clients and other sector stakeholders for trainings, workshops, debrief meetings and planning sessions. Two vehicles and assorted office equipment were transferred to DMS by USAID when the SALES project closed mid-year; the value of the equipment transferred was about $71,000 which DMS was able to reprogram into technical activities.

Last year saw a significant ramping-up of project activities in terms of both number and variety of technical assistance to help create an inclusive financial sector in Malawi. The increase in activities was made possible by an additional $600,000 obligation received in October 2005 under a USAID/EGAT PRIME funding grant. This additional money permitted the project in March to recruit the second and last technical specialist position on the project after it was put on hold in year one. It also allowed procurement of the services of short-term consultants and firms to carry out capacity building assignments for beneficiaries at all sector levels.

USAID's DMS project is the only "umbrella project" in Malawi providing support to the financial sector. In year one the project signed a memorandum of understanding (MOU) with PRIDE (Promotion of Rural Initiatives and Development Enterprises) and last year added four more with FINCA/Malawi (Finance for International Community Assistance), OIBM (Opportunity International Bank of Malawi), MUSCCO (Malawi Union of Savings and Credit Cooperatives) and MAMN (Malawi Microfinance Network). These structures supply 51% of all microcredit to the sector and 94% of that which is supplied by the private sector.

Malawi's microfinance sector is small and dominated by wholly-owned government entities. Most of the private sector financial service providers are on the knife's edge of operational sustainability; only a few have loan funds large enough to generate adequate revenues to approach full cost recovery. A previous lack of financial product diversity, coupled with small loan portfolios, has exposed even the largest microfinance institutions in Malawi to high covariant risk. In the last year, when the Government of Malawi (GoM) embarked on a vendor relocation drive, attempted to set floor prices for tobacco, took on a massive subsidized purchase and distribution of fertilizers, and disburse loans through the new Malawi Rural Development Fund at below-market interest rate loans, existing microfinance institutions suffered and became less financially viable.

USAID's assistance to the project's four key financial institutions helped them to deal with the losses but, except for a OIBM, their positions remain tenuous and continued support is needed to help them get to operationally sustainable performance levels and, to better prepare them for future shocks.

At the meso and macro levels, the project launched a series of initiatives around the promising but under-performing rural agricultural finance (RAF) value chains of coffee, tea, cotton, paprika and to a lesser extent dairy. Building on the work of USAID global bureau, DMS helped localize USAID's RAF workshop material and used it to launch seminars and market studies that exposed the full chain of value chain actors to opportunities and constraints in their sub-sectors. Participants responded extremely positively stating it was the first time they participated in such events. Most all found them useful to remove the information asymmetries that have led to invalid assumptions on both the supply and demand sides of financial services.

DMS carried out a mid-year study on the feasibility of establishing a Development Credit Authority Guarantee (DCA) program in Malawi. We confirmed a large unmet demand for finance at the small and medium enterprise level (SME) and several commercial banks and leasing companies were very interested to participate. Recent, dramatically downward trends in Treasury bill rates of return and a five point cut in the interbank lending rate are providing strong market encouragement for banks and others to develop new SME loan products. The DCA will help accelerate the effort and bring it about quicker.

At the macro level DMS took the technical lead to put on a national microfinance conference last year that sensitized a vast number of stakeholders to international best practices and Malawi's microfinance sector's problems, opportunities and constraints. DMS was also central to donor coordination meetings and decisions concerning projects and programs touching on the microfinance sector. Lastly, technical and financial support was provided to the Legal and Regulatory Taskforce's work to assess Malawi's enabling environment for microfinance and come up with a new microfinance bill and regulations.

Regarding project finance, with one year remaining, DMS has been obligated a total of $2,540,000 against the three-year contract ceiling price of $3,477,056. Since the field office was opened in January 2005, $1,450,778 was expensed through September 2006. The project's burn rate over the past year has been steadily increasing to its current level of about $100,000 per month. However, because of the technical activities in the pipeline this is projected to increase to about $130,000 per month. At that rate, additional funds would be needed by May 2007.

II. ADMINISTRATION

Year two administrative activities centered on the following:

- Ensuring that contract deliverables supplied to USAID are of a high quality;
- Recruiting, contracting, and mobilizing short-term consultants and subcontractors;
- Ensuring that the field office operations are fully compliant with Chemonics' and USAID operating policies and procedures;
- Maintaining effective and efficient communication channels between the home office project management unit (PMU) and the field office;
- Recruitment of the Commercial Finance and Enabling Environment Specialist (CF&EE) and retaining key project staff;
- Management of project inventory, leases and all related issues pertaining to the project office and the COP's living quarters;

The field office operations were supported in FY2006 by visits from two of Chemonics' head office staff based in Washington DC: Kate Woods, PMU Project Director who visited from October 19 - 28 and Ryan Flory Field Accountant from May 22 – 26. The purpose of Ms. Wood's trip was to conduct a standard monitoring visit that included meeting with USAID/Malawi, assisting the drafting of DMS's annual report, and participation in preparations for the DMS-led Malawi National Microfinance Conference held in November 2005. The purpose of Mr. Flory's trip was to conduct a customary mid-project field accounting audit which Chemonics carries out on all its project field offices.

A. PERSONNEL

The DMS field office technical team increased by one in FY2006 with the recruitment of Ezikiel Phiri in the position of Commercial Finance and Enabling Environment (CF&EE) Specialist. Mr. Phiri joined a field office team that has remained intact since the start of the project and consists of the Chief of Party (COP), Capacity Building Specialist (CBS), Accountant, Driver and an Office Custodian.

Mr. Phiri, a Malawian with extensive banking experience both in and outside of Malawi, started work on March 13. He had an immediate positive impact on the project's technical efforts as he oversaw the DMS initiative to improve and expand financial services that target key rural agricultural value chains. He also works to facilitate the commercial capital flow to micro, small and medium sized (MSME) Malawian businesses.

B. LEASES & PROCUREMENT

The project leases office space in City Centre Lilongwe and living quarters for the project COP. DMS's office includes a 1,000 m2 meeting/training room that is much used by DMS and its local partners who often utilize the room for in-house training, debriefing meetings or workshops. Considerable time and money were saved by avoiding the rental of outside facilities and led to DMS playing a supporting role in wide range of activities that took place at all levels of the sector.

The majority of DMS's office equipment was purchased in year one. However, with the addition of Mr. Phiri the project's one vehicle was insufficient to service the needs of the office. Also, in order to accommodate up to 50 guests that often took part in meetings held in the DMS conference room, additional chairs and tables were needed. These requirements were fully met when two vehicles plus assorted office furniture was transferred to DMS from USAID's SALES project which ended in June 2006.

The other major equipment acquisition was on behalf of PRIDE Malawi who requested assistance to upgrade its headquarters' local area network (LAN). Specifications for a server, PC's, laptops, printers, back-up systems, and assorted software were drafted by DMS and PRIDE, procured in the U.S.A. by Chemonics and air freighted to Malawi. The total investment cost was approximately $60,000.

III. TECHNICAL ACTIVITIES

The overarching objective of DMS is to deepen Malawi's financial sector and favorably impact the economic status and security of poor Malawian households. It aims to do this by supporting access to demand-driven financial services, helping to build sustainable financial institutions, facilitating the establishment of strategic alliances in the capital markets and assisting the government to create an enabling environment. DMS operates in a context where approximately 65% of Malawi's 11 million population lives under the national weighted average poverty line and an estimated 85% reside outside urban centers.

DMS project methodology combines a finance sector approach with one that works along rural agricultural finance value chains. It is market-driven with a focus on building local capacity to improve core competencies in the microfinance sector and supporting the development of a local financial sector industry that meets the needs of MSMEs and that can sustain itself in the long run. Three levels of the MSME sector are targeted: (1) **micro/retail level**: aiding high-potential micro finance institutions (MFI) to meet their goals of sustainability, outreach, and efficiency in a more effective manner; (2) **meso level**: building financial sector infrastructure, especially through local/regional support structures and working with high value agricultural value chains and commercial finance intermediaries; and (3) **macro level**: aiding the establishment of an enabling environment for the development of an inclusive financial sector.

In its second project year, DMS substantially scaled-up its technical activities in step with increased levels of USAID funding. The project client list expanded to include three additional MFIs. In deciding which structures to support, greatest weight was given to MFIs that were committed to implement best practices, charge full-recovery interest rates and fees, adhere to transparency in reporting, operate as specialized financial institutions, comply with USAID reporting requirements and agree to cost-share on the assistance provided by DMS.

Four new memorandum of understandings (MOU) between DMS and local institutions were signed in FY2005 to add to the one signed with Promotion of Rural Initiatives and Development Enterprises Malawi (PRIDE) in September 2005. These included: Opportunity International Bank of Malawi (OIBM) on October 19, 2005; Malawi Union of Savings and Credit Cooperatives (MUSCCO) November 18, 2005; Finance for International Community Assistance Malawi (FINCA) November 29, 2005; and the Malawi Microfinance Network (MAMN) on March 16, 2006.

In addition to building capacities at these five institutions, DMS supported the development of the sector by working closely with key government ministries, the Reserve Bank of Malawi (RBM), other donors, and agricultural value chain actors. Technical assistance was provided by a combination of direct assistance delivered by the DMS technical team consisting of the COP, CBS, and CF&EE and supplemented by short-term contracts issued to consultants and/or firms as well as support for regional training opportunities.

Since the DMS project is designed to interact at all levels of the microfinance sector, the technical section of this annual report is organized into project activities taking place at the micro, meso, and macro levels of the microfinance sector. Progress was made at all three levels and is described in detail below.

A. MICRO LEVEL

In Malawi the micro level of retail microfinance institutions (MFI) consists of wholly-owned government entities who dominate the sector and a small number of specialized MFIs and credit unions who account for about 53% market share of all micro savings and 40% of all micro loans outstanding. The DMS approach at the micro level consists of a combination of targeted technical assistance, customized training, generic "best-practice" training, and MFI assessments as precursors to full-fledged ratings.

A table listing the leading microfinance institutions, their legal status and market share is found below.

MICROFINANCE MARKET SHARE (at 30 September 2006)								
MF Providers	Legal Status	Savers			Loans			
		Number	Value (MK)	% (value)	Number	Value (MK)	% (value)
MRFC*	GoM Corporation	190,899	346,847,725	7%	80,526	725,267,977	22.69%
MARDEF	GoM Project	0	0	0%	39,000	400,000,000	12.51%
SEDOM	GoM Trust	1,262	446,919	0.01%	10,390	144,866,001	4.53%
DEMAT	GoM Trust	493	1,752,800	0.04%	340	5,541,986	0.17%
MSB	GoM Corporation	42,180	2,136,000,000	46%	220	1,041,497	0.03%
Public Sector SUBTOTALS		234,834	2,485,047,444	**53%**	130,476	1,276,717,461	**40%**
MUSCCO	Cooperative	57,038	789,513,435	16.99%	23,257	635,108,284	19.87%
OIBM	Bank	50,526	1,107,809,149	23.84%	8,258	628,806,791	19.67%
FINCA	Corporation	17,324	125,863,845	2.71%	17,324	206,259,361	6.45%
PRIDE	Corporation	10,597	44,337,062	0.95%	6,777	169,540,491	5.30%
FITSE	Trustee Act	0	0	0%	12,364	102,873,300	3.22%
ECLOF	NGO	0	0	0%	4,161	50,712,548	1.59%
CUMO*	NGO	10,352	8,629,857	0.19%	10,467	47,970,000	1.50%
Coffee SACCOs	Cooperative	1962	1,700,000	0.04%	1,962	35,960,000	1.13%
MicroLoan Found	NGO	0	0	0%	6,645	18,879,771	0.59%
Hunger Project	Project	4,240	1,475,666	0.03%	3,850	12,753,176	0.40%
PRDO	NGO	0	0	0%	1,263	9,000,000	0.28%
NABW	NGO	445	668,700	0.01%	121	1,569,225	0.05%
Project Hope	Project	3,495	81,429,594	2%	2355.00%	141,752	0.00%
Private Sector SUBTOTALS		155,979	2,161,427,308	**47%**	96,473	1,919,574,699	**60%**
TOTALS @ 140 MK / USD		**390,813**	**4,646,474,752** **$ 33,189,105**	100%	**226,949**	**3,196,292,160** **$ 22,830,658**	100%
** MRFC data is as at september 2006 which is the time of their lowest ag loan period of year*							
** MUSCCO data is as at 31 August 2006*							

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

Because Malawi's population is mostly rural, infrastructure is poor and state-owned institutions providing microfinance dominate the sector, the DMS project initially found that stakeholders lacked a widely shared understanding of best practices at all sector levels. However, over the course of the project's first two years, this changed considerably for the better and the majority of stakeholders that DMS has interacted with are now receptive to creating an inclusive financial system and building their institutional capacities along best practice lines. This is particularly true of the four MFIs with which DMS signed MOUs. Using information in the table above, these four represent 44% of the total savings mobilized in the sector and 51% of the loans outstanding. More significantly is their share of the market served by the private sector which is 94% and 85% of microsavings and microloans respectively. USAID's support for these key institutions is critical to the long-term health of the sector and an important counter-balance to the dominant position of the GoM in microfinance.

DMS Client	Savings			Loans		
	No.	MK	Mkt Share	No.	MK	Mkt share
MUSCCO	57,038	789,513,435	17%	23,257	635,108,284	20%
OIBM	50,526	1,107,809,149	24%	8,258	628,806,791	20%
FINCA	17,324	125,863,845	3%	17,324	206,259,361	6%
PRIDE	10,597	44,337,062	1%	6,777	169,540,491	5%
Totals	135,485	2,067,523,491	44%	55,616	1,639,714,927	51%

Table 2: Private Sector MFIs Receiving USAID Support

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

A.1 SECTOR-WIDE MFI CONTACTS

DMS meets regularly with all major providers of microfinance in the country through both individual meetings, stakeholder gatherings or other events. These occasions provide opportunities for the DMS team to disseminate information on best practices and provide expert technical advice on major internal and external challenges facing the sector. Unlike the project's first year which saw the launching of the government's Malawi Rural Development Fund (MARDEF) and much discussion regarding its operations and impact on the sector, last year's sector-wide discussions and stakeholder meetings were dominated by the Malawi Microfinance National Conference held in November, vendor relocations mandated by the government and the work of the legal and regulatory taskforce to investigate changes to the legal, regulatory, and supervisory framework for microfinance and other non-bank financial services.

Besides DMS's major work with FINCA, PRIDE, OIBM, and MUSCCO, DMS met regularly with senior management from Concern Universal Microfinance Organization (CUMO), World Vision's Finance Trust for the Self-Employed (FITSE), Ecumenical Church Loan Fund (ECLOF), Development of Malawian Enterprises Trust (DEMAT), Small Enterprise Development Organization of Malawi (SEDOM), and Malawi Rural Finance Company (MRFC) to discuss the business impact of government initiatives such as the setting of floor prices for tobacco, fertilizer subsidies, vendor relocations and MARDEF. As all of these institutions are members of MAMN, they also benefited from training offered through the network as well as from value chain workshops and credit supply and demand study reports that DMS organized which provided them with market intelligence to help identify new business opportunities.

FINCA Malawi

FINCA was the first institution to receive DMS assistance in year one of the project. However, at the start of second year the new FINCA Managing Director temporarily halted further cooperative efforts when he refused to provide FINCA's performance indicators on a quarterly basis although the requested indicators are standard for all USAID projects and the Microenterprise Results Reporting (MRR) system. However pressure was applied by FINCA/Malawi's middle and senior level managers who had benefited from DMS-led training earlier in the year wanted assistance to continue and FINCA's office in Washington informed the Managing Director that such indicator reporting to USAID was normal. Because of this, FINCA signed an MOU with DMS in December.

FINCA/Malawi's last two years were tumultuous, triggered by FINCA International's view that the Malawi program lagged far behind the financial performance of other FINCA programs in the region. Besides stagnant growth in its loan portfolio, it suffered from a high portfolio at risk (PAR), low credit officer efficiency and too many loss-making branches. Over the past six months a turn-around plan based on lessons-learned from leading microfinance operations in Uganda, Congo and Tanzania was developed by FINCA's Vice President for Africa based in the USA and FINCA's Regional Credit Director, based in Tanzania, who is temporarily Acting Managing Director for FINCA/Malawi. To turn things around it revamped operations and product lines, closed non-profitable offices and opened others in high potential areas.

A new incentive scheme and performance monitoring plan for credit officers was instituted by FINCA last year. As a result, nearly 50% of the credit officers who started the year were either let go or resigned by the end of September 2006. FINCA International's drive for excellence and intolerance for missed targets extended to senior management as well. The one-year contract of FINCA's third Managing Director since January 2005 was not renewed in July 2006 and recruitment for the Finance Manager and Operations Manager positions were recently conducted.

DMS supported the change process through direct technical assistance and training delivered by the DMS Capacity Building Specialist (CBS). In July the CBS led a three-day training of sixteen loan supervisors in best practices and branch supervision skills. In addition, DMS was asked to co-finance several consultancies including new product development, process mapping, market research, and business credit profiling. Much of this work draws on MicroSave Toolkits and utilizes short-term MicroSave-certified consultants who have successfully executed the same assignments for FINCA elsewhere.

Photo 1: FINCA Central Region Supervisors Training

The introduction of a redesigned individual loan product should improve profitability and is consistent with the belief that more demand-driven products are needed to deepen and broaden the market. DMS is helping FINCA to conduct market research and develop a new cadre of loan officers to handle the individual loans. This should avoid the high arrears FINCA experienced in the past when it introduced poorly-designed payroll and individual loan products that were rushed to the market without proper preparation.

According to FINCA International, USAID's capacity building assistance to support the reengineering process is the most important element needed to make the changes work. At the close of the year, several consultancies were in process and others were in various stages of implementation with completion dates in FY2007.

MUSCCO

MUSCCO is Malawi's only apex savings and credit cooperative. It is made up of sixty-six Savings and Credit Cooperatives (SACCO) dispersed throughout the country, especially in rural areas. It accounts for roughly 15% of all savings mobilized and 20% of all loans outstanding in the sector. MUSCCO develops and leads training sessions, underwrites savings and credit insurance on SACCO products and conducts annual internal audits of all its members. It also operates a central risk facility that intermediates deposits from SACCO's holding excess liquidity and on-lends the funds to SACCOs unable to meet their members' credit demand.

MUSCCO signed an MOU with DMS on 18 November 2005 that listed its top assistance priorities as:

- Improved governance and management
- Better financial management and risk control
- Computerization and improvement of information technology for SACCOs
- Development of a SACCO rating system and the development and implementation of a MUSCCO branding strategy
- Work with the GoM and MUSCCO to modify the cooperative law to create an improved legal, regulatory, and supervisory framework for credit unions

In 2006 DMS and MUSCCO collaborated to redesign its yearly SACCO training schedule that led to SACCOs assuming a greater cost share percentage and more need-based and practical course content. In the legal and regulatory area, DMS supported the work of the Microfinance Legal and Regulatory Taskforce whose purpose is to guide a review of the enabling environment and recommend changes to existing laws governing the registration, regulation and supervision of microfinance providers. MUSCCO's Managing Director is also a member of this Taskforce.

DMS sponsored two MUSCCO/SACCO staff to attend the September 2005 SAM/MicroSave training in Kenya and the DMS Capacity Building Specialist helped them apply the training to their jobs over the past year. One of many outputs seen was the drafting of a new strategic plan by the Branch Manager of the new FINCOOP SACCO in Lilongwe that was critiqued by two MicroSave consultants DMS hired to lead training for the Malawi Microfinance Network (MAMN) in May. Helped by the fine-tuning, implementation of the plan contributed to a nearly a three-fold increase in membership at FINCOOP in the last twelve months.

In July DMS and MUSCCO co-drafted the terms of reference for an international expert to be teamed with a local consultant to develop and test a SACCO rating tool. After advertising for the assignment, a local consultant was identified. But, a qualified expatriate to lead the work could not found by the end of FY2006 despite the best efforts of Chemonics' home office and MUSCCO's Managing Director and his colleagues on the World Council of Credit Union's international board. This assignment was therefore delayed to FY2007.

Photo 2: MUSCCO Strategic Plan Workshop

The last capacity building investment in MUSCCO occurred in September when SACCO leaders joined the MUSCCO board and senior management in a three-day workshop to draft MUSCCO's new five-year Strategic Plan. As with all assistance to DMS partners, the activity was cost-shared with USAID in this case funding approximately 75% of the total costs.

The table below shows trends in key performance indicators (PI) of MUSCCO members over the year. The influence of agriculture-related financing can be clearly seen by noting the large value of loans disbursed during the peak growing season from October through December and the decline in savings deposits due to some self-financing by farmers during the same period. Additional discussion on MUSCCO's PIs is found in the Monitoring and Evaluation Section of this report.

Selected PIs - MUSCCO	Oct 05 - Dec 05	Jan 06 - Mar 06	Apr 06 - Jun 06	Jul 06 - Sep 06
Total # loans disbursed	25,430	25,515	28,612	27,163
Value loans disbursed (MK)	166,311,023	27,259,789	49,202,040	38,061,549
Total # depositors (voluntary & forced)	51,624	51,301	50,455	57,038
Value deposits (MK)	495,388,658	695,587,292	805,299,965	789,513,435
Portfolio at risk (%)	9%	9.00%	9.00%	9.00%
Number new products	0	1	1	0

Table 3: MUSCCO Selected Performance Indicators – Project Year 2

PRIDE Malawi

PRIDE began operations in the year 2000 with funding assistance from UNCDF and is legally registered in Malawi under the Companies Act as a for-profit company limited by guarantee. It operates twenty-five of Malawi's twenty-eight districts via regional, branch and satellite offices, providing microloans that total about 5.5% of all loans outstanding in the sector.

An MOU was signed with DMS in September 2005 at which time PRIDE identified the following capacity-building needs:

- A staff training needs assessment
- Information Technology (IT) systems optimization
- Institutional assessment as a preamble to rating
- Leadership & governance training
- Microfinance best practice training

Over the past year USAID investments in PRIDE included completion of a DMS-led training needs assessment begun in August 2005 followed by customized staff training, process mapping of key operations and subsequent redesign of operating manuals, IT systems optimization, and provision of technical assistance by DMS technical specialists.

Due to high staff turnover caused in part by poaching of staff by the new GoM-run Malawi Rural Development Fund (MARDEF) start-up, many of PRIDE's supervisors had been promoted without adequate preparation and credit officers were also being rushed to the field with varying levels of orientation training. To address this problem, DMS conducted a staff training needs assessment, developed and then led three customized training programs for senior credit officers, branch and regional managers and senior head office staff. The training topics included:

- MF best practices and how these apply to PRIDE Malawi
- Supervision & leadership
- Management of information flow
- Branch performance analysis
- Time management
- Communication and team building

In the course of this DMS assistance work, it became evident that PRIDE needed to update and revise its operations manual as staff at all levels interpreted policies and procedures differently, which led to non-standardized implementation and weak compliance with expected operating standards. After the DMS training, senior PRIDE management was given a written report with recommended changes that included undertaking a process mapping using the toolkit developed by MicroSave. The process mapping toolkit is normally used to assess adequacy of internal controls in procedures to manage risk.

PRIDE's Managing Director agreed with DMS and a process mapping exercise was begun in January and completed in April. The process mapping team was led by DMS's CBS and PRIDE's Southern Regional Manager who USAID supported to attend last year's SAM/MicroSave training in Kenya. They were joined by two branch managers, two loan officers, and one regional manager. Senior management assigned the team to map five processes:

1. Micro Enterprise Committee (MEC) formation
2. MEC meeting management
3. Loan processing
4. Default management
5. New staff orientation

Each process map that was developed gave three views of the operational process: as it is currently implemented, as it should be implemented if existing procedures are followed, and how it would look if adjusted for maximum effectiveness and efficiency. Thus, process maps allow for identification and correction of inefficiencies and reduce misinterpretation of institutional policies. Senior management approved the final maps which improved the institution by: standardizing credit operations process flows across the branches and regions; providing precise direction to staff when conducting credit operations training and updating procedure manuals; and providing a sound monitoring tool for policy compliance.

Using the maps, PRIDE incorporated them in its operating manuals and then trained all of its credit officers and direct line staff. Based on the extremely positive feedback and results it went on to develop four additional maps on it s own last year that included:

6. Loan appraisal
7. Loan Disbursement
8. Cage/Teller System
9. Loan Insurance Fund (LIF) Refund

It also indicated that it will be expanding the mapping process to other departments starting with its internal audit group.

As a result of USAID's assistance over the past year, PRIDE now more closely monitors staff compliance with policies and procedures and systematically sets performance targets and measures whether they have been achieved. Notable changes are seen in staff attitude at most branches where managers now pay close attention to controlling costs and reducing delinquency thanks to a marked improvement in adherence to established policies and procedures.

The last element of assistance in FY2006 was an information technology upgrade to PRIDE's local area network at its headquarters. This was desperately needed to ensure data security and operating system integrity. The previous peer-to-peer network linked together equipment of various ages and performance and exposed PRIDE to a high risk of data manipulation and/or loss. An IT consultancy paid in part with a CGAP grant helped analyze the hardware and software needed and the DMS Chief of Party, working with Chemonics' headquarters and local experts put together a list of necessary upgrades to create a secure and performing LAN with server, workstations, printers, and other equipment. The items were procured in the USA and shipped to Malawi to realize cost savings. The network will be installed in December 2006 when PRIDE is expected to move to a new location.

Although the last year was a very difficult time for PRIDE as evidenced by the high portfolio at risk it reported, it managed to begin turning things around and it recorded a much better PAR as FY2006 came to an end in September. The timely and critical investments by USAID last year played a significant role in preventing a deepening of the crisis and laid the groundwork for better performance ahead through enhanced institutional capacity in terms of operating systems and procedures, computerization, and more knowledgeable and trained personnel. However, its capacity needs are many and USAID is PRIDE's only current source of assistance. Continued help is therefore crucial to maintain the momentum if PRIDE is to survive. Its inability to intermediate savings and its high debt to equity ratio prohibit further leveraging of commercial funds to increase operating revenues to satisfactory levels.

Selected PIs - PRIDE	Oct 05 - Dec 05	Jan 06 - Mar 06	Apr 06 - Jun 06	Jul 06 - Sep 06
Total # loans disbursed	3,498	2,033	3,387	3,111
Value loans disbursed (MK)	97,354,500	57,545,600	110,563,669	100,645,036
Total # depositors (voluntary & forced)	9,994	10,005	10,586	10,597
Value deposits (MK)	51,547,771	49,426,499	46,924,698	44,337,062
Portfolio at risk (%)	19%	32.00%	21.00%	13.14%
Number new products	2	0	0	0

Table 4: PRIDE Selected Performance Indicators – Project Year 2

OIBM

OIBM received its commercial banking license in May 2003. Its mission objective is to deepen access to banking services for the poor in Malawi who would otherwise lack access to any banking system. OIBM is part of the Opportunity International Network which is U.S.A.-based and operates programs in 31 countries around the world. It received start-up grant assistance from USAID/Malawi and DFID that has recently ended and it was just awarded a two-year innovation implementation grant from USAID/EGAT.

In October 2005 OIBM signed an MOU with DMS with a focus on assistance for staff development. During the year, DMS supported a wide variety of local and regional training sessions on a cost-sharing basis. More than ninety-two staff was trained in such topics as leadership and communication skills, loan evaluations, human resource development, audit and risk management, institutional values and culture, and new staff orientation to name a few. The trainers were mainly OIBM and OI employees, both international and national, but on two occasions consultants from South Africa delivered leadership and communication courses. DMS also supported four OIBM senior managers to attend regional trainings in South Africa and Kenya. OIBM has been a key participant in DMS's rural agricultural value chain workshops and is attempting to get a "first-mover" advantage in the tea sector by displacing in-kind estate grower credit that dominates the smallholder tea market.

OIBM informed DMS that supervisor performance, particularly at the mid-management level, improved significantly as a result of last year's training: problems are being dealt with at the appropriate level and solutions are being found. In addition, internal training capacity has grown as key staff have become effective trainers of others.

Expansion continued during the year with new branches opening in Kasungu and in Limbe. The Malswitch biometric smart card has opened up new relationships with Limbe Leaf and Alliance One who now use OIBM to disburse payrolls by loading salaries onto employee Malswitch cards. This in turn has opened up a market for payroll loans to the same employees. Also in the past year OIBM was one of two Malawi institutions to issue loans to groundnut farmers that are guaranteed by crop index insurance through NICO, a local insurer. A new loan product for vendors was introduced following GoM-forced relocations. Other new products are in the pipeline as OIBM continues to research new products and services, especially in e-banking, to extend outreach in rural areas. As the table below shows, the demand for microsaving services continues to be proven. OIBM's conservative policy on savings-led growth and carefully designed loan products has kept PAR at a respectable 2% following a rough period in mid-year when its core clientele of vendors and loans to tobacco farmers were disrupted by government interventions.

Selected Pis - OIBM	Oct 05 - Dec 05	Jan 06 - Mar 06	Apr 06 - Jun 06	Jul 06- Sep 06
Total # of loans disbursed	2,663	1,909	3,483	4,575
Value of loans disbursed (MK)	95,346,287	96,905,687	219,190,792	237,277,525
Total # of depositors (voluntary & forced)	41,364	41,179	47,236	50,526
Value of deposits (MK)	571,000,000	747,082,424	889,945,329	1,107,809,149
Portfolio at risk (%)	3.09%	4.70%	4.62%	2.02%
Number of new products	0	0	1	0

Table 5: OIBM Selected Performance Indicators – Project Year 2

Malawi Savings Bank (MSB)

MSB was mandated by the GoM to disburse loans issued under the MARDEF facility, despite its misgivings about the way it was set up to run. Over the course of the year, DMS met periodically with MSB to stay current on new developments and attempt to influence its implementation to incorporate best practices as much as possible. MARDEF loans totaling about 400 million MK were disbursed through the end of September 2006. Loans carried a minimum grace period of 3-6 months with some up to one year. As a result, the first repayments of most loans are yet to fall due. Because of the politicization of the MARDEF scheme and poor methodology the arrears are expected to be high. Initially MSB aggressively recruited new staff and MFIs such as PRIDE and FINCA were severely crippled by the loss of key staff, particularly at mid to senior levels.

Other MFIs

DMS held individual visits and technical exchanges over the year with FITSE, CUMO, NABW and ECLOF to receive updates on their outreach and discuss DMS developments. These operations benefited from off-the-shelf training programs that DMS offered to microfinance practitioners through MAMN. They also indirectly benefit from DMS's work at the meso and macro levels. However, because of the smaller size of their programs, the fact that they exist within larger multi-sector development agencies and are not stand-alone MF providers, DMS has not used its limited funds to provide customized technical assistance for them.

Two institutions newly interested in microfinance sought DMS counsel last year: the Connect Hope/Participatory Rural Development Organization (PRDO) and the International Committee for People's Development (CISP). Both work in the area of livelihoods and food security. In addition, CISP undertakes training of entrepreneurs and tries to link them to financial institutions and PRDO has a small credit component within their broad activities. Since neither specialized in microfinance, suggested they should consider joining MAMN where they would be exposed to best practices. Both joined the network last year.

B. MESO LEVEL

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

DMS met often in individual and group meetings with MAMN, donors active in Malawi microfinance, projects involved in rural value chains and other sector stakeholders. The meetings frequently included government representatives operating at the macro level, particularly with regards to MARDEF and possible changes to the enabling environment for microfinance.

Microfinance National Conference

The United Nations General Assembly voted that 2005 should be designated the International Year of Microcredit (IYM). In recognition of that, Malawi's microfinance stakeholders' group expanded to form an IYM National Committee to guide activities supporting the development of Malawi's microfinance sector. The culmination of activities was a National MF Conference that took place in Lilongwe on November 28 and 29, 2005.

The conference titled "Building an Inclusive Financial Sector in Malawi" brought together more than 100 national and international participants representing a broad cross-section of private sector companies, government and non-government organizations and donors. Funding was provided by UNCDF, UNDP and USAID. USAID, through the DMS Project, played the lead technical role through its work on the Conference Steering Committee Taskforce which guided the extensive pre-conference technical preparations and logistical planning.

The conference explored four themes: (1) legal and regulatory framework for MF and non-bank institutions led by the Reserve Bank of Malawi; (2) rural and agricultural finance led by MRFC; (3) best practices for microfinance institutions led by MAMN; (4) new markets in Malawi for rural finance led by AICC (Africa Institute for Corporate Citizenship). These themes were developed in biweekly steering committee as well as one-day focus group discussions (FGD).

The FGD organized by the MRFC was attended by the National Association of Smallholder Farmers of Malawi (NASFAM), Tobacco Association of Malawi (TAMA), Land-o-Lakes dairy project, and others. Participants explored why rural finance carries a high cost of delivery and discussed the effect of distortions promulgated by the GoM that limit the expansion and delivery of sustainable rural microfinance. The second FGD led by MAMN tackled the topic of Best Practices for Microfinance Service Providers. Some of the issues explored by participants included poor MFI governance, inadequate infrastructure, weak institutional capacity and market distortions caused by government activities such as MARDEF. The last FGD was led by AICC and examined New Markets for Microfinance in Malawi and included agricultural value chain actors such as tea estates, Cheetah paprika, fertilizer and seed suppliers, commercial banks, Celltel cellular, Malswitch (biometrics bank card supplier), and microfinance institutions.

Feedback at the FGDs and conference was lively and led to a better shared understanding of the characteristics of Malawi's MF sector and the various opportunities, risks and challenges that it faces at the micro, meso and macro levels. The high level of interest shown by banks, estate growers, agriculture input suppliers and others led DMS to organize other activities later in the year that brought together actors involved in high potential, rural agricultural finance (RAF) value chains. These activities are described elsewhere in this report.

Malawi Microfinance Network

MAMN has seventeen members (up from fourteen in 2004) that currently provide microfinance services or provided credit in the past and retain an interest in the sector. It is a nascent network that has only one full-time treasurer/secretary and lacks a managing director. Therefore the board of directors and its working committees are expected to make most management decisions. The lack of a full-time manager constrains the ability to adequately play its rightful role of representing the interests of its members in lobbying the government and educating the public.

DMS and MAMN signed an MOU in March 2006 which guided the support provided to MAMN over the balance of last year. Key activities included sponsorship of a MicroSave training workshop, assistance in the development of a new five-year strategic plan for the network, travel expense support to attend regional MF network meetings, and direct technical assistance provided by DMS staff.

Training In May, a three-day Strategic Marketing Planning Workshop led by two MicroSave trainers from Kenya was co-sponsored by DMS and MAMN. Following DMS's advice, MAMN changed its usual practice of offering training for free and instead charged tuition fees of Malawi Kwacha (MK) 10,000 for MAMN members and MK 15,000 for non-members. DMS paid only for the advertising of the workshop and for the consultants who led it. All lodging, transport and per diems, if needed, were supported by the participants themselves. Thirty-two participants signed up generating revenues of MK 390,000 for the network.

Travel to Uganda to Participate in AMFIU General Assembly Two MAMN representatives (C. Majawa, Chairman and C. Mbewe, Administrator) were invited to attend the annual meeting and ten year anniversary activities of the Association of Microfinance Institutions of Uganda (AMFIU). DMS paid the airfares while AMFIU covered lodging and meals; MAMN paid all other miscellaneous expenses. As a result of the visit, MAMN identified six areas to include in its next five-year strategic plan: restructuring of MAMN membership, establishment of better links with donors and government, the need for a training facility housed in MAMN, establishment of a microfinance law and support for the establishment of an Apex structure to provide capital for on-lending to MFIs.

New Five-Year Strategic Plan *With DMS's sponsorship, a three-day strategic planning workshop* led by Isaac Chiphazi of the Malawi Institute of Management (MIM) was held in August and attended by twenty members plus representatives from the MoTIPSD, MoA, RBM, UNDP/UNCDF and DMS. Participants redefined the mission and vision of MAMN and its key strategic objectives and these were captured in a strategic plan that was being circulated to members for approval when this report was written. Key changes include amendment to the trust deed and members' code of conduct, enlargement of eligible members to include non-microfinance providers, and establishment of a fully-staffed secretariat.

Photo 3: MAMN Strategic Planning Workshop

Lobbying Efforts DMS helped MAMN prepare position papers for various meetings called by the MoTIPSD on issues effecting MFIs in the country. Among other things, these included addressing an edict by government to relocate all vendors in the country to designated areas, an investigation into high interest rates and weekly repayment terms on loans issued by MFIs following a speech by the President at which he asked the MoTIPSD and MoF to look into such practices which he considered abusive to micro entrepreneurs, and follow-up meetings to establish a Microfinance Forum comprised of key stakeholders following the National Conference on Microfinance held in November 2005.

Rural Agricultural Finance Value Chains (RAF)

At the invitation of USAID, the COP and two OIBM employees attended a three-day Rural Agricultural Value Chain workshop in Johannesburg that investigated how to integrate innovative approaches to stimulate growth and productivity along agriculture value chains and projects that seek to deepen and expand finance to MSMEs. The topic proved perfectly suited to Malawi and DMS and USAID/Malawi as was envisioned when DMS received $600,000 in USAID/EGAT PRIME funds in FY2005 to work in RAF, among other things.

RAF Workshop To help DMS localize the RAF workshop materials for Malawi, USAID/EGAT hired DAI who worked closely with DMS and USAID/Malawi to adapt the material to local needs. A subsequent workshop was attended by twenty-eight value chain actors from the cotton, tea and coffee sectors who developed value chain diagrams that identified the actors in each chain, how they related, and what were the financing needs at each level. Participants enthusiastically supported the opportunity to interact in such a forum stating it was the first time banks, MFIs, smallholder farmers, resource input suppliers and other value chain actors came together to discuss common needs in their sub-sectors. All commercial banks except one sent representatives to the workshop and each indicated the workshop allowed them to became better sensitized to MSME financing needs.

Coffee & Tea Credit Demand/Supply Study It became evident during the RAF workshop that there were severe information asymmetries btween finance providers and MSMEs. To help overcome this, a credit supply and demand study for the tea and coffee sectors was co-funded by USAID/DMS and the EU/Joint Food Security Task Force (JFSTF) housed at the Ministry of Agriculture. A local consultant firm, Kadale, was contracted to do the work, a questionnaire was designed and administered to all value chain actors in the two sectors and reports drafted. Separate debrief meetings for tea and coffee were held in June and October respectively to discuss findings and incorporate feedback into two final reports.

The tea debrief meeting was well-attended by forty-three senior managers representing the stakeholders listed in the table 6.

Tea Workshop Participants		
	Number	
Category	**Individuals**	**Institutions**
Estates	10	5
Smallholder Associations	7	3
Input Suppliers	2	2
Banks	8	7
MFIs	7	5
Development Partners	6	4
Other	3	2
Total	**43**	**28**

Table 6: Tea Debrief Meeting Participants

Key findings were:

- Tea estates were largely self-financed due to misconceptions on finance available such as a perceived mismatch between finance needs and credit terms and denominations, fluctuations in the price of tea, and high interest rates on MK loans;
- Total financing extended by banks to estates in 2005/2006 season was about US $7.2 million and was primarily for working capital credit lines that covered about 50% of working capital needs;
- Information asymmetries between suppliers and demanders of financial services constrained expansion of the sector at all levels;
- Leasing is currently little-used but could have a high demand;

- USAID's Development Credit Authority might greatly increase financing flows to MSME's;
- Estates are the only source of finance to smallholder tea growers; estates gave in-kind loans of fertilizer, chemicals and farm implements valued at about US$280,000 to 8,500 growers in the 2005/2006 season;
- Much land exists that could be brought under smallholder production if medium-term finance for new plants could be identified.

Since the coffee sector value chain is different than tea, the final study for coffee due in October will describe different opportunities and constraints. However, what is emerging thus far is the existence of financing gaps that may be closed with better market information passing between suppliers and users of financial services such as was seen in the tea sector.

It is still early to quantify new financing taking place as a result of USAID's RAF work. Yet, banks, estate growers, MFI's, smallholder farmers, and input suppliers individually reported that serious efforts are underway to increase financing flows to the tea and coffee sectors as a result of the work DMS has initiated.

Future DMS activities in RAF will initially follow the same model used in tea and coffee to prepare a credit supply and demand study in other sectors, such as cotton. In addition, DMS will continue to facilitate the development of new demand-driven financial products in promising sectors and pursue the establishment of a DCA mechanism in Malawi, with USAID/Malawi's support, to increase commercial bank finance to Malawi's underserved MSMEs.

US Government Development Credit Authority Study (DCA)

Based on discussions DMS has had with MFIs, banks and MSMEs in Malawi since the start of the project, the demand for financial services exceeds the supply. At the MFI level, the shortfall is due in part to inadequate capital for on-lending as MFIs, with the exception of SACCOs, are unable to intermediate savings and thus are cut off from a low-cost source of funds. Commercial banks, on the other hand, are highly liquid which they have invested in low-risk GoM treasury bills offering very high rates of return.

Over the last two years however, the T-bill rates have reduced by nearly one-half to around 23% and they are expected to fall further following the announcement in September that Malawi reached the completion point under the HIPC (Highly Indebted Poor Countries) initiative. This accomplishment led to a cut of slightly more than 90% of Malawi's total official foreign debt from US$3 billion in nominal terms to around US $400 million. This amounts to a savings of about 15% off the country's national budget that will sharply cut the government's need to raise funds through T-bill sales, which will in turn lead to cuts in the interbank lending rate.

Undoubtedly, anticipation of these developments contributed to the high interest shown by commercial banks in the DMS-led RAF workshops and value chain finance studies. However, banks still perceive MSME loans to be "risky" and are reluctant to change their lending practices to build an SME loan portfolio.

For these reasons, USAID/Malawi and DMS are exploring the introduction of a DCA program in Malawi. An expert on DCA from Chemonics' Home Office helped DMS conduct a detailed market assessment in the last quarter of FY2006. The assessment team met with key financial market and economic sector actors, including all major commercial banks and non-bank financial institutions to introduce the DCA concept and gauge interest. The study concluded that there is solid market support for a DCA facility in Malawi to increase the flows of commercial finance to SMEs by establishing DCA loan portfolio guarantees at commercial banks. Success will depend upon designing a facility that includes helping banks build their capacity to adapt their loan products to the SME client who typically does not fit the bank's current notion of a "credit-worthy client".

MARDEF

MARDEF is a new GoM initiative launched by the President of the Republic to make loans available to a majority of citizens. It was initially proposed during the 2004 presidential campaign and it steadily grew in size until Parliament increased the size of the fund to five billion MK (about $40 million USD) in January 2005. If this amount were disbursed, it would more than double the existing volume of microloans in the country. Unfortunately the guidelines of MARDEF are seriously flawed and the process of loan application and approval are seen as highly politicized with the common attitude that most loans will never be repaid.

MARDEF sent a letter in January 2006 requesting DMS to fund an exposure trip to Uganda, indicating that the delegation would consist of people from Budget and Finance Committee, Malawi Savings Bank, Ministry of Finance and MARDEF Board and Secretariat. While DMS did not fund the trip which eventually took place in September and was 100% paid by the GoM, it did provide technical assistance on who to see in Uganda and what information should be gathered.

APIP Restructuring

DMS was invited by the EU to provide input to its decision-making process to restructure its Agricultural Productivity Investment Program (APIP) which came to a close on June 30, 2006. Depending on the collection of loans outstanding, the remaining loan fund is estimated to be between MK 600 to 900 million (US $4.2 – 6.4 million). At the time of this report, the option favored by the EU is to solicit expressions of interest from commercial banks to take over the remaining loan book and cash assets of APIP and both on-lend capital to MFIs for their operations as well as directly to agri-businesses through the bank's own structures. DMS supports this as the best option available.

C. MACRO LEVEL

The most appropriate role of government is to aid the development of inclusive financial systems characterized by vibrant, sustainable MFIs by concentrating on creating an enabling environment. However, the GoM has taken on a much larger role than that as it not only sets the legal and regulatory framework but is the largest retailer of microfinance services in the country.

Over the course of the year, DMS was at the forefront to increase the level of shared understanding of best practices by all stakeholders in Malawi's MF sector. The numerous stakeholder and consultative meetings that DMS led, or participated in, were opportunities for stakeholders to take stock of the current challenges facing the MF sector and introduce how it might be improved if generally accepted best practices were embraced at all levels. The National Conference in November was a major help to expose key government ministries to both the opportunities as well as the challenges faced by microfinance service providers. In particular, the Reserve Bank of Malawi (RBM) and the Ministry of Trade, Industry and Private Sector Development (MoTIPSD) were well sensitized over the course of the year and are very supportive. However, the Ministry of Finance (MoF) and government supporters of MARDEF have so far not committed themselves to building an inclusive financial sector according to known best practices.

Reserve Bank of Malawi

The Reserve Bank of Malawi (RBM) was the lead agency responsible for the development of the National Conference theme exploring the legal and regulatory environment for microfinance in Malawi.

It also held the chair on a Microfinance Legal and Regulatory Framework (L&R) Taskforce that was responsible for supervising a review and analysis of Malawi's microfinance legal and regulatory framework and the drafting of a new microfinance bill and supporting regulations. DMS met often with the RBM and helped lead them through a bench review of the latest literature and findings related to microfinance legislation, regulation, and supervision from around the world.

Funded by a US $60,000 African Development Bank grant, the L&R Taskforce signed a contract in January with the local consulting firm of Agro-Ind Serve to carry out the work described above. With the agreement of the Taskforce, DMS enlisted the IRIS Center at the University of Maryland, a subcontractor to Chemonics on the AMAP Financial Services IQC, to provide expert review of both draft reports and to participate in the second stakeholders meeting that DMS agreed to finance.

The first report, a situational analysis, was determined to have serious shortcomings that were detailed by stakeholders at the two-day debrief meeting held in May. It was redrafted several times before it was finally accepted, albeit with reservations, by the Taskforce. The draft MF Bill and Regulations was expected in August but as of September 30, it was still not written. Based on the earlier report, it is essential that the MF Bill and Regulations be thoroughly reviewed and amended as needed. If not, there is a very high risk that the legislation will severely hinder the development of Malawi's microfinance sector and most definitely not enable it. USAID's investment through the work of the DMS project will help ensure that this will be done.

Ministry of Trade, Industry, and Private Sector Development
Another ministry that worked closely with DMS last year was the Ministry of Trade and Private Sector Development (MoTIPSD) under whose sponsorship the national conference was held.

GoM's Microfinance Policy Statement approved by Cabinet in 2002 was also sponsored by the MoTIPSD. Because of concerns that it was hastily drafted and not widely circulated led to the conclusion that it wasn't serving the intended purposes. So, a workshop was held in August 2005 that brought together key stakeholders to review the existing document, comment to its appropriateness and describe ways to improve it. Participants concluded that the MF Policy Statement was on the whole appropriate but needed to be updated, redrafted in a more formal style and presented to the current Cabinet for signature. Once approved, it would be published and disseminated to a wide audience.

The MoTIPSD solicited DMS's assistance to redraft the MF Policy Statement taking into consideration the comments by stakeholders. The IRIS Center was contracted for this purpose and a revised draft was prepared and circulated to a limited number of people for comment. It is expected to be finalized in November 2006 and discussed at the debrief meeting to be held on the draft Microfinance Law and Regulations. If not for USAID, this work would not be financed and it iss unlikely it would be done.

IV. FINANCE

Project expenses are tracked against the three cost categories in the DMS task order: Labor, Materials, and G&A. The original budget for DMS in its first two project years was $1,280.917 in year one and $1,094,090 in year two for a total of $2,375,386 or 68% of the total contract ceiling price of $3,477,056. However, because USAID obligated fewer funds over the first two years than expected, only $1,450,778 was expensed through year two. This represents 61% of the original budget and 42% of the contract ceiling price with only one-third of the project period remaining.

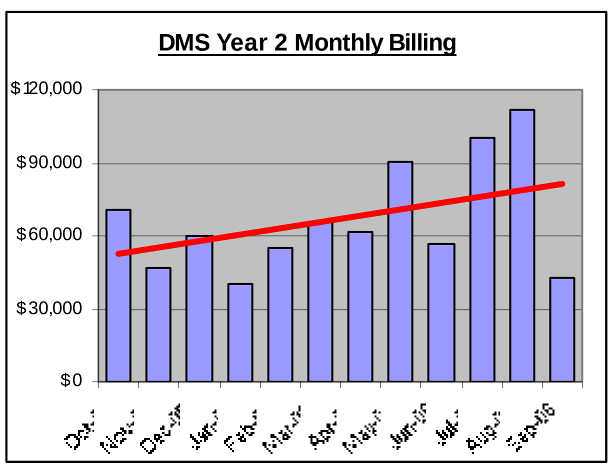
The shortfall in obligated funds to-date necessitated a delay in the hiring of the second DMS technical specialist until the sixth month of year two. Cutbacks were also made in the utilization of short-term consultants and technical assistance subcontractors and the financing of training, travel, and equipment purchases.

In the DMS labor budget line item, the Chief of Party and the Capacity Building Specialist took up some of the funding shortfall by providing direct technical assistance to microfinance sector actors and MOU partners. Under the materials line item USAID helped out by transferring office furniture and two vehicles valued at about $71,000 from the USAID/SALES Project when it closed. Because of these and other cost-saving measures the project has been able to roughly maintain its expected ratio of line items to total budget. In comparison to the figures seen in Table 7, the original budget projected ratios of 54% for labor and 43% for Materials.

Line Item	FY 2006 Quarterly Expenditures				Total Year 2	
	Q1	Q2	Q3	Q4		%
Labor	105,257.96	93,707.85	130,614.34	129,476.62	*459,057*	*57.1%*
Materials	68,991.46	64,854.44	72,766.06	118,422.77	*325,035*	*40.5%*
G&A	3,449.61	3,242.72	5,597.05	7,105.40	*19,395*	*2.4%*
Total	***$177,699***	***$161,805***	***$208,977***	***$255,005***	***$803,486***	*100%*
Line Item	**FY 2005 Quarterly Expenditures**				**Total Year 1**	
	Q1	Q2	Q3	Q4		%
Labor	31,710.92	110,567.25	93,142.14	101,132.48	*336,553*	*52%*
Materials	73,848.97	58,646.12	90,655.81	73,271.26	*296,422*	*45.8%*
G&A	3,692.50	2,932.31	4,029.05	3,663.60	*14,317*	*2.2%*
Total	***109,252***	***172,146***	***187,827***	***178,067***	***647,292***	*100%*

Table 7: DMS Quarterly Expenditures over Life of Project

As for obligations, DMS received $2,540,000 in total obligations to-date, with the FY2006 obligation of $750,000 arriving in September 2006; the next obligation is not expected until FY2007. Of this amount, the balance of obligated funds not yet expended as of September 2006 was $1,090,502. However the average expenditures per month have steadily increased, especially since the CF&EE Specialist joined the team mid-way through the year. Besides his labor cost, project technical support at all three levels of the financial sector have increased substantially to about $80,000 per month as can be seen from the graph to the right. It should be noted that the very low billing in September was due to a change in Chemonics accounting software which resulted in 50% of field expenses not being captured in the September invoice.



Graph 1: DMS Monthly Billing

Moving into year two, DMS's monthly burn rate is expected to continue the upwards trend seen over the last year to an estimated $130,000+ average per month over the first six months. This is due to increasing assistance at PRIDE, FINCA, MUSCCO, and OIBM, a sharp increase in Macro level assistance on the new MF Bill and MF Regulations, and support to design the new DCA loan guarantee program. Therefore this heightened level of activity will require additional obligated funds by May 2007.

V. MONITORING AND EVALUATION

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

A. MICRO : DMS-SUPPORTED FINANCIAL INSTITUTIONS

The indicators discussed in this section are A1 through A8 and refer to the combined indicator reports from FINCA, PRIDE, MUSCCO and OIBM who received direct capacity building assistance under the DMS project.

On the micro level, the performance indicators (PIs) track the evolution of the financial strength and outreach of DMS client institutions using individual institution reports and combined data that measure the overall outreach in the sector. It should be noted that in Malawi the peak time for micro loan portfolio size is the end of December when the outstanding agricultural loans are at the maximum. This contrasts with the monitoring and evaluation data reported in the annexes which are collected at the fiscal year end of September, a time when microloans are at their lowest since farmers generally purchase agricultural inputs in October.

The combined performance of the four assisted institutions was strong with all targets exceeded except for A6, loan loss ratio. Cumulative loans disbursed increased by 18%, numbers of loans by 317%, number of depositors 20%, and value of deposits by 70%. Key ratios such as portfolio at risk (PAR) improved as it moved from 19% overall to 8%; return on assets, though still negative, improved from -11% to -3%. Loan loss ratio however got worse moving from 1% to 3%.

While the overall numbers were encouraging, the picture at the individual institutions varied widely. OIBM had a very strong year as it opened new branches in Kasungu and Limbe and continued to deepen its market penetration in Lilongwe. Its loan portfolio is 38% of the combined total of PRIDE, FINCA, MUSCCO and OIBM and its share of total savings is 53%. However, note that only OIBM and MUSCCO can legally intermediate savings.

MUSCCO and its member SACCOs were severely affected by the low prices paid at the auction floors for tobacco following the unsuccessful attempt by the GoM to set a floor price that was ignored by buyers. This led to delays in tobacco-related loan repayments, higher write off, loss of interest revenue, and reduced capital base, all of which showed up in weaker performance indicators. What helped MUSCCO's overall reporting was the strong performance by its newest SACCO, FINCOOP which recorded strong growth and healthy savings and credit portfolios. USAID contributed to FINCOOPs strong performance as described earlier in this report.

FINCA and PRIDE are both in transitional periods during which time their financial performance has been very weak, but is trending positive as the year ended. Staff turnover at all levels was both a cause and effect of poor performance. In the case of FINCA, the loss of the APIP apex funds for on-lending to agriculture cut into the number and value of loans outstanding and return on assets. Problems with poorly designed payroll and individual loans led to very high write offs and temporary suspension of those products until they are redesigned. However, USAID's assistance contributed to month-to-month improvements as PAR went 11.2% in July, 9.5% in August to 9.2% in September with October expected to be around 7.25%. Net operating margin has been negative but is trending to positive, having been reduced by 30% from August to September. Continued USAID assistance is needed over the next two years to continue the gains shown in order to ensure the survival and eventual growth of this important private sector MFI.

PRIDE's financial performance has likewise improved over the course of the year, albeit at a slower pace than FINCA. Yet, the performance was very positive: PAR improved from a baseline last year of 18.5% to 13% at year end, loan loss ratio from 5.6% to 0.1% and return on assets from -15% to 1.1%. However, PRIDE had to write off a large number of individual and payroll loans that were not designed properly and were poorly managed. Like FINCA, it is unable to intermediate savings and that fact that it is already highly leveraged with lines of credit at banks limits its options to increase net revenues. Like FINCA, PRIDE's market position is tenuous and USAID's support is essential over the next year and more for the gains to continue so that net profit can move from the red to the black.

B. MICRO LEVEL – SECTOR WIDE

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

***Outstanding loan value and total number of loans outstanding*:** Overall, outstanding loan value increased by 31% to MK 3.2 million, while the total number of loans outstanding decreased by 28% to 229,000. This was due primarily to MRFC who had nearly 100,000 fewer cumulative loans compared to last year as a result of arrears and losses on tobacco loans. The APIP program wound down in 2006 and this reduced the total numbers and value of loans disbursed as well.

Number of depositors and total value of deposits mobilized: The value of deposits increased by 121% to MK 4.66 million although numbers of depositors decreased by 7% to 403,890. The increase in value was largely due to the performances of OIBM (274%), MSB (173%) and MUSCCO (65%) who together accounted for market shares of 24%, 46% and 17% respectively.

It is encouraging to note that for the first time in Malawi, both the value microsavings and the number of clients with microsavings deposits exceeds the value and number of microloans outstanding. This is confirmation that appropriate savings services are in demand and that the intermediation of savings can help close the gap in microcredit supply and demand which is constrained by the lack of loan capital.

C. MESO LEVEL

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

The first indicator, B1, measures the level of information sharing and transparency between MAMN member institutions by tracking the level of reporting to MAMN as required by the network's Code of Conduct but this reporting requirement is not noted in the Code. However, as part of the MOU that MAMN signed with DMS, members are required to report their performance indicators to the MAMN secretariat on a quarterly basis and these are forwarded to DMS. Since signing the MOU 90% of members have submitted indicators.

Indicator B2, regarding credit ratings was not achieved as MFIs supported by the project felt that other capacity building assistance was more important and because of obligated funding constraints not all demands could be fulfilled.

The third indicator, B3 measures the number of MF stakeholder meetings held. The target number of meetings was ten, and there were a total of twenty-six that were held. A large number of these were meetings of the steering committee that organized the national microfinance conference.

D. MACRO LEVEL

Macro level indicators attempt to measure awareness and dialogue around policy and regulatory issues. The target for the number of policy and best practice events was ten. Over the course of the year, there were forty-one events that included the MF National Conference, training for MFIs (FINCA, PRIDE, OIBM, MUSCCO, MAMN), meetings with the Legal and Regulatory Taskforce, debrief meetings on credit supply and demand studies, rural and agricultural finance workshops and debriefings, stakeholder meetings at the MoTIPSD, EU, and others.

ANNEX 1: MICRO-LEVEL DMS PERFORMANCE INDICATORS

A. Micro Level - DMS Assisted MFIs: FINCA, MUSCCO, OIBM, PRIDE

Performance Indicators (DMS Clients)		Baseline Source	Sub-category	Baseline Value	Target	Period : Oct 05 -Sep 06 Actual MK	Value USD	Achieved	Comments
A1	Total value (cumulative) of loans disbursed	Previous report	Total (male + female	1,720,528,491	20% above the previous year	2,034,931,847	$14,745,883	**18%**	Acheivement largely due to increase at OIBM. MUSCCO showed a 29% decline due largely to tobacco loan losses because of low auction prices. PRIDE declined by 6% due to high arrears on payroll and individual loans
			Male	612,623,721		713,891,739	$5,173,129	**17%**	
			Female	1,107,904,770		1,179,675,738	$8,548,375	**6%**	
			% total lent to ag-related sectors	6%		183,377,708	$1,328,824	**9%**	Increase attributed to OIBM. MUSCCO experienced decline due to arrears on tobacco loans and the halting of APIP loans through FINCA.
A2	Cumulative number of loans disbursed during period	Previous report	Male	26,580	At supported MFI's, 10% improvement over baseline	110,954	n/a (not applicable)	**317%**	Data is presented as it was reported by MFIs. However, because MOUs were signed at different times of the year, the baseline is underestimated since it is a
			Female	31,069		55,950	n/a	**80%**	
A3	Number of depositors	Previous report	Total (male + female	112,646	At supported MFI's, 10% improvement over baseline	135,485		**20%**	OIBM, FINCA and MUSCCO all increased by more than 10%. PRIDE declined by 10%.
			Male	56,629		75,428		33%	
			Female	56,017		60,057		7%	
			Savings	97,141		119,635		23%	
			Guarantees	35,049		15,850		-55%	
A4	Total value of deposits mobilized	Previous report	Total (male + female	1,214,822,544	10% above sector assessment baseline	2,067,523,491		**70%**	OIBM led the increase with 94%, followed by MUSCCO at 65% increase, FINCA at 14%. PRIDE declined 21% as borrowers drew down savings to repay loans
			Male	703,473,067		1,094,520,342	$7,931,307	56%	
			Female	511,349,477		973,003,148	$7,050,747	90%	
			Savings	971,858,035		120,813,549	$875,461	-88%	
			Guarantees	242,964,509		5,050,296		-98%	
A5	Portfolio at Risk (PAR) ratio	Baseline at time MOU is signed	-	19%	Baseline for supported MFIs determined	8%		**8%**	Overall PAR improved significantly. OIBM at <2%, MUSCCO at 9% (down from 10%), FINCA at 9.2% (down from 19%) and PRIDE at 13% (down from 18.5%). Nonetheless, PAR Is still at very high levels at all instituions except for OIBM and this is hurting profitability.
A6	Loan Loss Ratio	Baseline at first time LLR is calculated after MOU	-	1%	Baseline for supported MFIs determined	3.06%		**3%**	OIBM again leads the way with 0.3%, followed by PRIDE at 0.1% (due to an aggressive provisioning policy), MUSCCO at 4% (up from 3% last year) and FINCA at 8%.

A. Micro Level - DMS Assisted MFIs: FINCA, MUSCCO, OIBM, PRIDE

Performance Indicators (DMS Clients)		Baseline Source	Sub-category	Baseline Value	Period : Oct 05 -Sep 06				Comments
					Target	Actual MK	Value USD	Achieved	
A7	Return on Assets (ROA)	Baseline at first time LLR is calculated after MOU	-	-11%	Baseline for supported MFIs determined	-3%		**-3%**	Overall ROA improved but considered individually, it was a disappointing year for PRIDE, FINCA and MUSCCO in terms of profitability.
A8	Number of new or improved loan products developed by project-supported MFIs	Zero	-	0	5 for all supported MFIs?	9			FINCA had 2, MUSCCO had 2, OIBM 3 and PRIDE 2

A. Micro Level: Promoting Strong Retail-level Institutions

Performance Indicators (DMS Clients)		Definition	Frequency	Baseline Source	Baseline Value	Period: Oct.05 - Sep.06				Comments
						Target	Actual MK	Value US $	Achieved	
A9	Total value of loans outstanding in MF sector	Total value of micro credit loans at ALL MFIs reported in MK and also in US$ converted at exchange rate on September 30th	Annually	MF Sector Assessment Report	2,454,600,202	10% above previous year	3,210,671,560	$23,265,736	31%	Exchange rate applied $1 = 138MK, inculdes MK 223million increase by MARDEF
A10	Total number of loans outstanding in MF sector	Total number of micro credit loans outstanding at all institutions operating in the MF sector	Annually	MF Sector Assessment Report	309,922	10% above previous year	229,390	-	-26%	Reduction primarily due to MRFC (100k fewer loans) with reductions also noted at PRIDE, FINCA and OIBM.
A11	Number of depositors reported in MF sector	Total number of micro finance depositors that have accumulated deposits as savings or as loan guarantees at all institutions operating in the MF sector	Annually	MF Sector Assessment Report	433,450	10% above previous year	403,890	-	-7%	Loss in numbers due to inability of all but MUSCCO, OIBM and MSB to intermediate savings. Other MFIs lost depositors when loan guarantees were seized for non-payment
A12	Total value of deposits mobilized in MF sector	Total value of deposits mobilized as savings or as loan guarantees, in the case of MFIs legally prohibited from mobilizing savings, at all institutions operating in the MF sector reported in MK and also in US$ converted at exchange rate on September 30th	Annually	MF Sector Assessment Report	2,115,366,949	10% above previous year	4,666,874,752	$33,817,933	121%	Target was largely surpassed due to very high savings amount mobilized by OIBM up by 274% to MK 1.1million. MSB inreased by 173% to 2.1 million

ANNEX 2: MESO-LEVEL DMS PERFORMANCE INDICATORS

B. Meso Level - Supporting Industry Infrastructure								
Performance Indicators (DMS Clients)		**Definition**	**Frequency**	**Baseline Source**	**Baseline Value**	**Oct.05 - Sep.06**		**Comments**
						Target	**Achieved**	
B1	Percentage of Malawi Microfinance Network (MAMN) members submitting performance indicators as stipulated in the MAMN code of conduct.	The percentage of MAMN members offering MF services that submit performance indicators on their institution's activities to the MAMN secretariat as stipulated in the MAMN members' Code of Conduct.	Annual	MAMN Survey at startup	Year prior to DMS startup	85%	90%	PI reports not stipulated in Code but MAMN MOU with DMS requires Qtly PI submission.
B2	Number of project-supported MFIs who pay part or all of the costs of a credit rating (each year)	USAID-financed MFIs will allow themselves to be rated using a MFI rating instrument such as MicroRate, Planet Rating, Accion International, or others.	Annual	MAMN Survey at startup	Zero	2	0	Institutions had other more urgent needs, SACCOs rating for MUSCCO stalled for lack of qualified consultants
B3	Number of MF stakeholders meetings held	MF Stakeholder meetings include broad representation from MFIs, parastatals, MAMN, reserve bank, Govt. of Malawi ministries, bilateral and multilateral donors, MF sector support structures, project staff.	Annual	MAMN Survey at startup	Zero at Project startup	10	26	Especially those related to MF National Conference Legal & Regulatory framework, MoTIPSD meetings, sectoral study debriefs,
B4	Number of project-supported MFIs that successfully access commercial capital (cumulative)	MFIs who capitalize a portion of their loan fund from commercial sources	Annual	MAMN Survey at startup	Zero	2	2	FINCA, PRIDE

ANNEX 3: MACRO-LEVEL DMS PERFORMANCE INDICATORS

C. Macro Level - Fostering a Conducive Policy Environment and Ensuring the Appropriate Role of Government							
	Performance Indicators (DMS Clients)	Definition	Frequency	Baseline Value	Period: Oct.05 - Sep.06		Comments
					Target	achieved	
C1	Number of DMS-supported MF policy and best practice events	DMS supported events could include such things as trainings, roundtables, conferences, stakeholders' meetings, etc… at which MF policy, MFI licensing, supervision, regulation, or best practices for an enabling environment are discussed.	Annual	zero	10	41	