

Donors Succeed by Making Themselves Obsolete: Compartamos Taps Financial Markets in Mexico

by Maggie Dugan with Ruth Goodwin-Groen

The support of international and Mexican donors helped Financiera Compartamos grow from a small, non-governmental organization to the largest microfinance institution in Latin America, raising funds in the financial markets while maintaining an unswerving commitment to serving poor women.

Overview

Compartamos began microfinance operations in 1991 as a small non-governmental organization (NGO) in Mexico. With the help of donors such as the US Agency for International Development (USAID), the Inter-American Development Bank (IDB), the Consultative Group to Assist the Poor (CGAP), and several Mexican businessmen, the NGO became a self-sufficient, regulated financial institution in 2001. No longer reliant on donor funding, Compartamos is now a highly profitable (with 18 percent adjusted return on assets), pro-poor microfinance bank that is fully integrated into the financial sector. It has twice tapped the financial markets, in 2002 and again in 2004, by issuing local-currency bonds.

Compartamos expanded its outreach significantly over the past 13 years. As of September 30, 2004, it boasted 100 branches in 22 Mexican states (including four of the poorest); 270,631 active clients; and a loan portfolio of US \$79 million with only 0.63 percent of its loans late by more than 30 days. Most significantly, Compartamos has not lost sight of its mission to help poor people, particularly women: over 95 percent of its borrowers live in rural communities and the bank's average loan size is US \$308.

The institution owes its successful transformation to intelligent management that focused on developing skilled human resources, attracting donors that recognized the MFI's potential to become a commercial institution independent of subsidies, and eliciting the right mix of technical and financial support from donors. Compartamos' donors took calculated risks that helped the burgeoning MFI stand on its own, rendering further donor assistance unnecessary.

The Development of Compartamos

Mexico's per-capita income is the highest in Latin America, but the country struggles with huge income gaps

between the rich and the poor. Despite progress in rebuilding the economy after the financial crisis of the mid-1990s, 40 percent of the population was still living below the poverty line in 2003.



A Compartamos client who is a potter in Oaxaca, Mexico. (Photo: Luis Castaneda Nunez, June 2004).

Compartamos began as a project of the NGO Gente Nueva. Inspired by Mother Teresa's commitment to aid the poor, José Ignacio Avalos created Gente Nueva in 1984 as a youth movement to promote social change and contribute to the economic development of Mexico. In 1990, it launched a pilot MFI to provide loans to rural women in Mexico. Formally established as the NGO Asociación Programa Compartamos in 1991, it became financially self-sufficient in 1997 and a fully licensed banking institution called Financiera Compartamos in 2001. Over the course of its trajectory from NGO to regulated finance institution, Compartamos benefited from the support of several public and private donors.

Appropriate Funding

Donor funding, which amounted to only US \$4.8 million in grants, enabled Compartamos to mature through successive stages of growth, ultimately preparing it to tap large-scale commercial funding.

Start-up funding focused on technical skills. In 1990, USAID provided Gente Nueva with a US \$50,000 grant for a pilot microfinance project. The project funded staff training in FINCA's village-banking methodology in the Mexican states of Oaxaca and Chiapas. In 1993, the IDB extended crucial funding that allowed Compartamos to expand. The IDB's mix of grant (US \$150,000) and loan (US \$500,000) funds came with strict reporting requirements, plus specific instructions on how to use the technical assistance grant. When the IDB first funded Compartamos in 1993, the MFI had no track record. "They trusted us anyway," said Carlos Danel, co-chief executive officer of Compartamos. "IDB gave us our first real infusion of capital."

"The IDB funding came at a moment when we were thinking as an NGO. We weren't thinking in a massive way, but in a local way. Sometimes it was difficult to follow their rules, but it helped us build a solid foundation."

Ivan Mancillas, commercial director, Compartamos

Unrestricted funding. Between 1995 and 1998, Compartamos received approximately US \$300,000 in grants from six Mexican lenders. In addition to these grants, Alfredo Harp Helu, president of Banamex, the Citicorp subsidiary in Mexico, became an advisor to Compartamos and donated US \$1 million to the MFI from his own pocket, together with a US \$300,000 grant from the Banamex social development fund. These donations helped Compartamos maneuver through a challenging growth period.

Performance-based funding. In 1996, CGAP gave Compartamos a US \$2 million, three-year grant. However, in 1996, CGAP began using a performance-based model for MFI grants, and Compartamos was a strong candidate for testing the model. The first tranche of the grant was designated for installing accounting and management information systems. Successive funding was conditioned on Compartamos meeting three performance benchmarks: (1) an arrears rate below 10 percent, (2) client growth of at least 25 percent annually, and (3) a specific annual target for return on assets for each of the three years.

Compartamos outperformed the minimum CGAP thresholds on every count. Its portfolio at risk over 90 days was 2.3 percent in 1997 and dropped to 0.1 percent by 2000. The goal of 39,000 active clients was reached in

two years instead of three, and the MFI's average return on assets was positive within six months of signing the grant agreement.

"We always had the goal to reach one million clients, but [at] the beginning, it was really a romantic goal. CGAP helped us make it a real target. This was the first time someone linked investing in us with our performance. CGAP proposed a grant contract linked to three targets and then they stood back and watched us perform."

Carlos Danel, co-chief executive officer, Compartamos

Capitalization funding. In 1999, Compartamos teamed up with investor/partner ACCIÓN to apply for an innovations grant from USAID. The US \$2 million grant was disbursed through ACCIÓN in three parts: \$800,000 purchased equity in Compartamos, \$1 million was lent to Compartamos by ACCIÓN as subordinated debt, and \$200,000 was extended as a technical assistance grant. The latter was used to initiate the MFI's outreach in Mexico City, an essential element of its future growth and long-term outreach. Until that time, Compartamos had focused exclusively on rural lending and had no products or experience in urban markets.

"It was [crucial that Compartamos] go into Mexico City to set up branches and develop products that made sense for urban lending. We couldn't reach our goal [of serving one million poor Mexican women] without this component."

Carlos Danel, co-chief executive officer, Compartamos

Building Technical Capacity

Compartamos' donors and investors were seasoned professionals with the technical expertise needed to develop the institutional capacity of the young microfinance institution. Two donors in particular, Alfredo Harp Helu and CGAP, oriented the MFI in its early stages toward becoming a self-sufficient, commercial institution serving the poor over the long term.

Acquiring a banking mind-set. Banamex President Alfredo Harp Helu was Compartamos' first link to the private financial sector in Mexico. Harp brought tremendous banking expertise to Compartamos, helping it modify its lending techniques, strengthen supervision (and thus, portfolio quality), and raise its effective monthly interest rate to cover the cost of over 50 percent inflation.

"I had the feeling that supervision and control was key for the development of the business. I helped them build systems."

Alfredo Harp Helu, president, Banamex, and private donor to Compartamos

Building management capacity and an international network. When Compartamos applied to USAID for funding in 1995, five years after its initial training grant, the agency refused the request and suggested instead that Compartamos management attend the microfinance training course at the Economics Institute in Boulder, Colorado. In 1996, Ivan Mancillas and Co-Chief Executive Officer Carlos LaBarthe attended the Boulder course, where they were able to network with experts and other microfinance practitioners. Since then, 90 percent of the Compartamos management team has attended the training course, deepening the skill base of its team.

Building efficient business systems. When CGAP began working with the MFI in 1996, Compartamos did not even know the exact number of loans or total funds in its own portfolio. “We didn’t hide this fact,” said Danel, “but they were patient and helped us build a system so that we would know.” CGAP Senior Advisor Rich Rosenberg sensed that the Compartamos management was smart, serious, and eager to learn. He was impressed with how, even at the earliest stages, Compartamos managed loan repayment. “You have to be on the ball to get loans repaid. When you see people who are active, aggressive, and creative about that process, it’s an encouraging sign. It’s probably the best single proxy of program performance and management capability.”

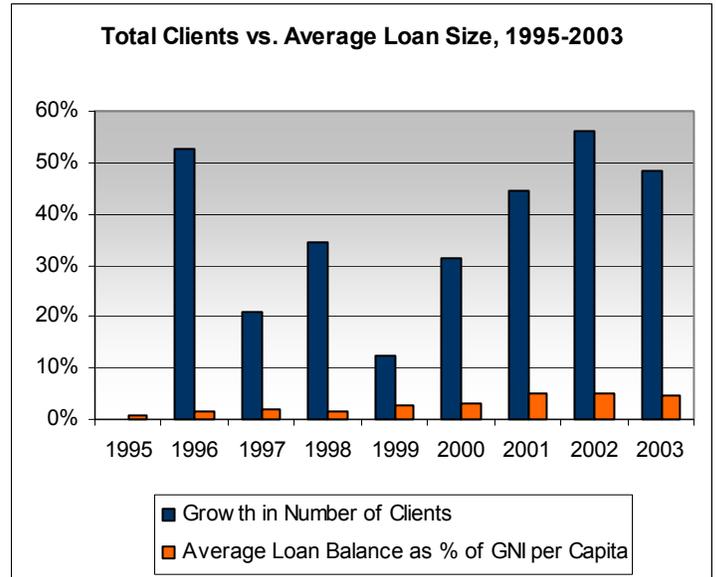
CGAP advised Compartamos to take the time necessary to establish a lending system required to reach a large scale, including training loan officers, making loan decisions, following up on delinquent loans, and especially managing information. CGAP worked with the co-directors to orient them on the basics of microfinance, and then stepped out of the way. “[GCAP] didn’t try to drive us in another direction,” said Danel. “They helped us do what we wanted to do, but better.”

Tapping the Financial Markets

Mexican banking regulations put savings out of reach for MFIs that were neither banks nor credit unions. So MFIs like Compartamos had to find a way to access capital markets to fund growth. Compartamos adopted a strategy of building a profitable business model so that it could eventually become licensed and issue bonds. However, Compartamos first got its feet wet in the commercial sphere by pursuing bank loans, which still account for 40 percent of its liabilities. Issuing debt opened the door to a larger and deeper pool of funding in local currency at the right price, allowing Compartamos to grow rapidly and diversify its funding base.

Equity funding. In 1998, Compartamos began the transformation from an MFI to a licensed banking

institution (specifically, a limited-scope financial institution). It stopped soliciting donor funding, and in October 2000 when it received its license for lending, Compartamos invited investors and private funders to become equity partners. By the end of 2000, the MFI had raised US \$5 million from shareholders. Four years later, as of third quarter 2004, Compartamos had multiplied this equity eightfold from retained earnings.



Source: World Development Indicators database (WB Intranet).

Bond issues. In July 2002, Financiera Compartamos issued a 200 million MXN bond (US \$20 million) guaranteed by the organization’s financial strength. The bond issue targeted retail investors to provide additional loan capital to increase the MFI’s outreach. The three-year, 13.1-percent bond received an A+ rating from Standard and Poor’s (S&P). In the first tranche for 100 million MXN (US \$10 million), 20 percent of the investors were institutions and 80 percent were individuals. In the second tranche (issued in November 2002 for 50 million MXN), institutional investors purchased 50 percent of the bonds. The majority of the third and final tranche (issued in April 2003) was purchased by the same types of investors.

In 2004, Citigroup/Banamex placed a first tranche of 190 million MXN (US \$16 million) in a bond issue totaling 500 million MXN (US \$44 million). The issue received AA local ratings from S&P and Fitch, thanks to a 34-percent guarantee provided by the International Finance Corporation. All of these funds have been used solely to finance portfolio growth.

Balancing growth, profitability and client interests. Compartamos’ remarkable success in the bond market is based on its high profitability, low debt-to-equity ratio, and prudent fiscal policies. For example, it funds much of

its 60 percent annual asset growth from retained earnings. To date, it has paid about 4 percent of current book value in dividends to equity investors, 66 percent of which are socially responsible investors. Compartamos considers these dividends to be largely symbolic: they are the ultimate signal to investors that microfinance generates real profits. The MFI has financed both its growth and dividend payments by charging high annual interest rates: approximately 88 percent in 2004, down from 120 percent in 2000. There is much debate within the microfinance community about whether its interest rates should be further reduced. However, Compartamos believes that consistent significant growth and a financial institution that is prudent, stable, and holds a long-term vision best serves the greater needs of its clients.

Advice to Donors from Compartamos

Upon reflecting on their experience of the transition from an NGO to a fully regulated financial institution, the managers of Compartamos offer the following advice to donors:

1. **Understand an MFI's goals.** Some donors are reluctant to let go of their own agendas, and end up driving an MFI in a direction it wouldn't normally choose. Listen to the MFI and help it achieve its goals, not yours.
2. **Help strengthen management.** Undertake due diligence and work closely with the MFI to build a transparent relationship based on trust. Support training and technical assistance.
3. **Keep contracts simple.** Keep contracts short and to the point. Propose grant contracts linked to simple, clear, and credible performance targets.
4. **Keep reporting requirements concise and focused.** Reports are important, but can steal time and distract an MFI from doing what must be done to reach performance targets. Require information that is truly useful and helps the donor monitor overall performance, not day-to-day activities.
5. **Don't require specific consultants.** If a donor has taken time to study and understand the institution and its goals, it should be able to recommend advisors and technical experts. But do not *require* that MFIs work with specific consultants.
6. **Ensure the MFI can run a consistent and profitable core business, then help it access commercial funding.** Tapping capital markets allows an MFI to diversify its funding. However, the institution must have the systems in place to run a commercial operation at scale before such funding is feasible.

Conclusion

Donors looking to support a success story like Compartamos must plan on making themselves obsolete from the outset. Successful MFIs use donor funding to become self-sufficient. Not only has Compartamos become fully integrated into the private financial sector of Mexico, it has proven that it is possible for a financial

institution serving poor people to do so profitably and also remain true to its mission.

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Websites

ACCION: www.accion.org

Bellanet: www.bellanet.org

Compartamos: www.compartamos.org

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