



A LETTER TO OUR PEERS

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WHAT WE BELIEVE IN

Since our IPO last year, the long standing discussions around the issue of the commercialization of microfinance have taken a renewed prominence. Many people in the industry have expressed concerns of where the IPO might take microfinance and others have praised it as a step forward in achieving a more inclusive financial sector. These are discussions we all in the industry should welcome, they are healthy ones. As the challenge to improve people's lives is large, these debates can make a major contribution to find the best ways to undertake it.

Through it all, we at Compartamos have been mostly silent, trying to listen to the concerns and perceptions of others. We believe that some of those discussions have led to very meaningful insights. However, we have struggled with finding a way to break our silence and participate in the debate constructively.

This letter aims to do that. It aims to share with the industry the core beliefs that have led Compartamos to follow the road we have followed. We are proud of what we have achieved, and by no means do we intend to change critic's minds. This is only an effort to put forth our beliefs so that we can be held accountable to them.

We believe in people, we believe that microfinance is finance and has to be sustainable, that economic value is a consequence of social value, that the main contribution of microfinance is the expansion of the market, that microfinance has great economic value, and that the challenge of combating poverty is much larger than microfinance itself.

WE BELIEVE IN PEOPLE

We are in the business of trusting people. This trust allows our clients to seize opportunities otherwise they would not have. Yes, mostly we provide working capital loans to microentrepreneurs, but that is only part of the story. Like many of the pioneers of microfinance¹, the Mission² that drives us is the creation of opportunities for those who have been excluded from them. It has been the perpetual lack of opportunities that have kept capable people from realizing their full potential, and that is what Compartamos is all about.

¹ "The creation of opportunities for the majority of people – the poor – is at the heart of the work that we have dedicated ourselves to during the past 30 years" Muhammad Yunus, Nobel Prize Acceptance Speech, Oslo, December 2006

² "We are a bank that generates social, economic and human value. We are committed with the individual, we generate development opportunities in popular sectors; these opportunities are based in innovative and efficient large scale models and in transcendental values that create both external and internal culture, developing permanent trust worthy relationships and contributing to the creation of a better world"



We offer our services to low income segments of the Mexican population³. We do not claim to work with the poorest of the poor and in fact we are convinced that they (the poorest) need much more urgent economic transfers in order for them to be in a productive state and be able to use a loan successfully⁴. This implies we believe in people's abilities and recognize their natural desire to prosper. In an open and free market, we are convinced our clients are in the best position to make the right choices for themselves and their families.

This includes the belief that having access to financial products is better than not having access at all. If financial services are an opportunity for higher income clients and corporations, why wouldn't they be an opportunity for low income clients? We understand and share the concerns that the opportunity can become a danger without proper financial literacy or consumer protection. As Lendol Calder noted, there is such a thing as 'wise borrowing' and 'foolish borrowing'⁵. People and institutions can and do abuse credit in a way it can harm them, but we believe it is not a valid reason to deny them access. The recent subprime crisis in the U.S. is a clear example of this abuse, something that has not occurred among microfinance clients in over two decades of serving clients in developing countries.

However, there is a clear need to focus on providing consumer protection and financial education along with financial services. This is why we have been pioneers in putting forth Consumer Protection Pledges in the Microfinance Network⁶ and Prodesarrollo⁷. We have also been strong supporters of the Transparency Law in Mexico⁸, and just in the past year, we have provided specialized financial literacy training for more than 60,000 people. Since 2001, we have entered more than a million people in the national credit bureaus⁹ not only to open doors for them, but also to make sure that, as competition increases, a good client is not harmed by overindebtiness, a concern we share with the Leaders behind the Pocantico Declaration who "are concerned by the rising risk of over indebtedness among clients in many markets"¹⁰.

We believe that microfinance provides opportunities, but is not by itself a solution to poverty alleviation. We agree with the Pocantico Declaration when it says: "*We affirm our ongoing confidence that microfinance can and should bring increases in income, assets and other benefits to our clients; but we acknowledge that microfinance is not a panacea*"¹¹.

³ We define our segment as C to D- based on the definitions by AMAI (Asociación Mexicana de Agencias de Investigación de Mercado y Opinión Pública), <http://www.amai.org/niveles.php>. A D- client earns approximately 10 dollars a day.

⁴ We have seen and hope to learn from the institutions that are breaking ground serving the poorest of the poor like BRAC in Bangladesh.

⁵ Financing the American Dream, Lendol Calder, 199, Princeton University Press.

⁶ The MicroFinance Network (MFN) is an international association of leading microfinance institutions. Through the MFN, 37 members from 31 countries share ideas, experiences, and innovative solutions to the challenges they face in search of continuous growth and progress. <http://www.mfnetwork.org/about-mfn.html>

⁷ Prodesarrollo is a Mexican network whose members promote financial culture among popular sectors. The network includes other networks, financial institutions, individuals and members from the academia. <http://www.prodesarrollo.org/Quienes-Somos.1.0.html>

⁸ Ley para la transparencia y ordenamiento de los servicios financieros (*Law for the transparency and regulation of financial services*)/ Diario Oficial de la Federación, 07-15-2007

⁹ Credit bureaus in Mexico are private institutions whose official name is *Sociedades de información crediticia* (Institutions of credit information). As of 2008, there are two main companies: *Buró de Crédito* (<http://www.burodecredito.com.mx/>), and *Círculo de Crédito* (<http://www.circulodecredito.com.mx/>)

¹⁰ The Pocantico Declaration, April 2008 www.microfinancegateway.org/content/article/detail/49313

¹¹ The Pocantico Declaration, April 2008. www.microfinancegateway.org/content/article/detail/49313



At the same time we have proven that the provision of microfinance services can bring with it the potential to build other things different from financial assets. In a recent study by De la Riva Group¹², Compartamos' clients showed a greater statistical level of self-esteem, financial literacy and solidarity than the control group. Much of this comes from true client service, which in Compartamos includes activities such as business workshops, yearly meetings to recognize our clients' work, and publications, among others.

We maintain microfinance builds social capital, and that is the greatest of the opportunities that we offer and that our clients value. So at the end of the day, we have come to understand that we are not always able to change our client's lives, but we are able to provide an opportunity for them to change their own lives. We are convinced this is worth doing.

WE BELIEVE THAT MICROFINANCE IS FINANCE

Pure financial intermediation is about allocating money saved by others to those deemed creditworthy and who can profitably invest it. This is what we do, and why microfinance is finance.

Good microfinance institutions are good financial institutions: those who can understand the needs of their clients and can provide products that add value to them and reduce risk in the process. We agree with the Pocantico Declaration that "*microfinance is distinguished by its primary purpose of maximizing long term value to low income clients in a sustainable manner. This can be achieved by the growing diversity of providers and approaches*"¹³. But even within these diverse approaches, microfinance has to be treated as finance, because it is no different from it.

However, we understand there are unique features about the microfinance industry. It is an industry born out of social concern, and we are convinced its greatest contribution lies in the creation of social value. Indeed, the social value of microfinance is that it can provide financial intermediation to low income segments of the population previously not served.

As a sound financial institution, microfinance must comply with best practices in terms of transparency, corporate governance, sound credit policies, innovation, client service, efficiency and cost controls. Being a true and robust financial institution has allowed MFIs to serve as a bridge between the pool of available financial resources and low income segments of societies, two universes quite far apart.

So as microfinance is finance, we are convinced what it does is expand and complement an incomplete financial sector. One that has excluded low-income clients for a long time based on the belief that they do not represent a business opportunity and are not creditworthy. Proving the opposite, in our view, is the best thing the microfinance movement has done for them and their wellbeing.

¹² De la Riva Group Mexico is a Market Research Firm. <http://www.delariva.com.mx/dlr/index.php>. The study can be found at www.compartamos.com

¹³ The Pocantico Declaration, April 2008. www.microfinancegateway.org/content/article/detail/49313



WE BELIEVE THAT MICROFINANCE HAS TO BE SUSTAINABLE

We all know providing credit to small borrowers is relatively expensive, which is why sustainable microfinance appears to have high interest rates with respect to the rest of the financial sector, in all countries.

The relative high cost of microfinance springs from the need to assure and assess credit worthiness under very difficult circumstances that explain the reluctance of the traditional financial sector to enter and serve this market. These reasons include: pervasive informality; lack of jobs in the formal economy; weak and undefined property rights; inability to assign, recognize, or price family assets; weak or absent judicial and legal remedies; no credit history and dispersed and difficult to reach clientele.

To remedy these shortcomings, microfinance has developed a unique methodology that allows financial intermediation for low income clients. We believe the main purpose and value of the methodology is to discover those persons that are creditworthy, collectively even if not individually. For the most part, microfinance extends credit to the word of its clients, with no collateral. A successful operation requires building social networks of committed borrowers and networks of specialized credit officers.

In Compartamos the process of providing credit involves the following: identifying and training a large number of socially committed credit officers; reaching out to groups of low income people that are potentially creditworthy; identifying and assessing their projects in collaboration with credit officers; building group capacity, extending credit for a 16 week period; and following up on supervision and collection.

That is why our cost is 152 dollars a year per client. This amount entails the following: training of credit officers, labor cost of credit officers, 52 visits a year, client materials, transportation expenses to visit groups, life insurance to pay credit balance, additional life insurance of 1,454 dollars¹⁴, and general expenses.

Table 1 shows that Compartamos incurs 152 dollars a year in the cost to service a client¹⁵ while it costs the average MFI's in the MIX¹⁶ 116 dollars, and it costs slightly more to service a client in large LAC MFI's (where costs are more comparable), with a cost of 174 dollars. So in essence, in nominal terms, Compartamos is more efficient in costs compared to its peers in large LAC MFI's. However, a very significant difference has to be pointed out: with a cost of 152 dollars, Compartamos services a 450 dollar loan on average, whereas with a cost of 174 dollars, a typical large LAC MFI services a 1,322 dollar loan. As most people know, interest rate is related to the amount outstanding, so a smaller loan amount results in a higher interest rate, if the cost of servicing the loan is similar. Even though Compartamos' costs are lower, they represent roughly 30% of the outstanding balance, which contrasts sharply with the 13% of large LAC MFI's. So in terms of efficiency, measured as cost per client, Compartamos is better off than large LAC MFI's. In terms of productivity, we witness

¹⁴ The amount is equivalent to 15,000 Mexican pesos.

¹⁵ This only relates to operational cost. As the reader can tell form Table 1, there are not any significant differences in financial expense ratios or loan loss provision expense ratios among peer groups.

¹⁶ The MIX stands for Microfiance Information Exchange. They are a web-based microfinance information platform and can be found at <http://themix.org>.



the same situation: borrowers per staff member in Compartamos stand at 196, while the average for large LAC MFI's is 135 borrowers per staff member.

If we look at cost even further, we have to mention the astounding achievement made by Large Asian MFI's who spend 29 dollars to service a 139 dollar loan (21% adjusted by GNI). However, it is important to distinguish the costs of operating in some Asian economies against operating in economies like Mexico. One of the main issues is the cost of labor. For comparison purposes, an average member of staff in Compartamos earns 16,885 dollars a year, an average member of staff in large LAC MFI's earns 12,300 dollars yearly, and yet the cost for average staff member in a large Asian MFI is 2,336 dollars a year. That is approximately 1/7 of what it costs Compartamos in Mexico. Adjusted for GNI per capita, the staff at Compartamos earns 2.15 times GNI per capita, while the Asian staff earns 3.2 times GNI per capita, so in comparable terms, the Asian staff is better compensated. Besides the salary burden, Compartamos has to come to terms with a multiplicity of other structural and regulatory factors, including: larger distances and lower population density, high regulatory compliance costs, and high costs related to infrastructure and telecommunications, among others.

The Mexican case is in fact quite special. Not only is the average loan balance per borrower significantly lower than other large LAC MFI's, but when adjusted by GNI per capita, the average loan balance per borrower for Compartamos is only 5.72% of GNI per capita. The same is true for our competitors in Mexico. This is hard evidence that the Mexican microfinance industry is unique in its depth outreach. As noted by Adrian Gonzalez, "*Mexico is the country with the highest depth of outreach based on GNI per capita in LAC, but many argue that this is due partially to the fact that Mexico is the richest country in the region, and that incorporating income distribution in the analysis is necessary to correct such distortions. However, as shown in Table 2, Mexico is also the country with the highest depth of outreach in LAC based on loan balances relative to the average GNI of the lowest 40 percent of the population*"¹⁷ If you look at the Table Mr. González is referring to in the Microbanking Bulletin, (shown at the end of this document as Table 2), you will notice that Mexico (and Argentina) not only has the highest depth of outreach in LAC, but also has the highest depth of outreach among all the 52 countries listed in the Table. Mexico is followed by Egypt with 10%, Philippines with 11% and China with 12%.¹⁸ This stands in stark contrast to markets like Bolivia, where the average loan balance is 120% of GNI per capita.

This also shows that in the case of Mexico the higher per capita GNI implies both that microcredit is allocated to lower segments of the society, and the operating costs will also tend to be higher in absolute and relative terms due to a richer economy.

Now, onto the topic of interest rates. By looking at Table 1 (at the end of this document), you will notice the yield on gross portfolio¹⁹ within a sample²⁰ of our competitors is between 62% and 104% while Compartamos stands in the middle at

¹⁷ Adrian Gonzalez, Lead Researcher, MIX. International comparisons of loan balances per borrower in the MicroBanking Bulletin, Spring 2008; see Table 2 at the end of this document.

¹⁸ Comparing unadjusted loan balances is subject to distortions related to different economies. Microfinance has normalized this by converting them to dollars and then comparing them to how much of local income, measured by GNI per capita does the loan amounts to. Lower numbers are a proxy per depth of outreach. In other words, when a loan is 20% of GNI per Capita as opposed to 100% of GNI per capita, it is assumed the institution is reaching lower income clients.

¹⁹ "While yields do not directly equate to interest rates, as a blended yield masks different pricing across products, they offer one Proxy for interest rates" Blaine Stephens, Chief Operating Officer and Director of Analysis, MIX from Bulleting Highlights, Microbanking Bulletin Spring 2008.

²⁰ Those where public information is available



79%. However, there are significant differences between peer groups using the MIX information; in the aggregate, the MFI's reporting to the MIX have a yield of 32%, MFI's using Village Banking Methodology²¹ have an average yield of 45% and MFI's targeting low end markets²² have an average yield of 39%. Therefore, as also pointed out by Rosenberg²³, although the interest rates Compartamos charges are not out of range with other Mexican institutions, they do seem out of range with a traditional MFI elsewhere, even if less so with those doing village banking in low end markets.

But as mentioned before, the most important differences between Mexico and other markets is loan size, both in nominal as well as in adjusted terms, as well as the wealth of the economy. If we had a loan size double of what we have, the implied interest rate would roughly be half of what it is today. Thus, a plea for lower interest rates is in fact a plea to increase the size of our loans significantly. Doing that can only have two outcomes: the over-indebtedness in our clients or moving to a different segment of the market, which amounts to mission drift. These have been identified in the recent Microfinance Banana Skins survey done by CSFI²⁴ among the top fastest rising risks in a booming microfinance industry. This is not what Compartamos plans to do.

We will do three things instead. First, keep pushing for greater efficiency by perfecting and evolving our business model by incorporating better processes, different channels and new technology²⁵. Second, offer new financial products to our clients which meet their needs and do not breach their payment capacity. Third, expand our client base.

WE BELIEVE THE MAIN CONTRIBUTION OF MICROFINANCE IS THE EXPANSION OF THE MARKET

Back in the early 90's, we bumped into a vibrant growing industry: microfinance. We were told by the experts, there was a 'market failure', as regular financial institutions were not willing to lend to low income clients. Muhammad Yunus recalls: "*The first thing I did was to try to persuade the bank located in the campus to lend money to the poor. But that did not work. The bank said that the poor were not creditworthy. After all my efforts, over several months failed, I offered to become a guarantor for the loans to the poor. I was stunned by the result. The poor paid back their loans, on time, every time! But still I kept confronting difficulties in expanding the program through the existing banks. That was when I decided to create a separate bank for the poor, and in 1983, I finally succeeded in doing that. I named it Grameen Bank or Village bank*"²⁶. This was an eye opener for us. What Yunus taught us was that this lack of access to credit by the poor was due to a market failure and not an intrinsic lack of credit worthiness. The challenge, then, was to put in place a market mechanism to solve this market failure. Indeed, transforming the market failure into a business opportunity, which in itself provides opportunities for low income clients.

²¹ Compartamos belongs to this peer Group as its primary methodology is Village Banking

²² As defined by the MIX, those that have an average balance per borrower/GNI per Capita <20% or an average balance per borrower < 150 USD.

²³ Focus Note No. 42 CGAP Reflections on the Compartamos IPO: a case study on microfinance interest rates and profits. CGAP, 2008

²⁴ Microfinance Banana Skins 2008, Risk in a booming industry. Center for the Study of Financial Innovation

²⁵ Although important, this will probably have the least effect. As MIX analysis has shown: 'reductions in operating costs taper off at relatively low thresholds of just 2,000 clients, with additional gains in efficiency diminishing significantly thereafter' Blaine Stephens, Chief Operating Officer and Director of Analysis, MIX from Bulleting Highlights, Microbanking Bulletin Spring 2008.

²⁶ Muhammad Yunus, Nobel Prize Acceptance Speech, Oslo, December 2006



That's when we learned of the power of using commercial principles to solve social problems. Back then, our first 10 years as an NGO allowed us to serve 61,000 clients. Five years later, as a for profit commercial financial institution, we were able to reach an additional 600,000 clients. Now we are approaching one million. In order to expand the market, we came to understand that we needed to aim for higher than average profits because we wanted to build an industry, and profits are, as in any other market, the mechanism to ensure market growth.

We achieved this by growing our assets on a rate of more than 50% a year for the past 7 years. In his paper, Rosenberg challenged that strategy to pursue growth: "*The years since 2000 have seen what can only be described as a flood of new publicly owned or socially motivated investors – IFI's and MIV's – who are anxious to invest large amounts in debt and equity of MFI's... We have little doubt that Compartamos has turned down expressions of interest from a number of these investors since 2000*"²⁷.

In fact, we were very much committed to prove that microfinance was investment worthy within the mainstream financial sector. Filling our balance sheet with socially motivated investors was attractive, but it crowded out mainstream investors in the long run. We understand this is a model-led choice, and respect anyone who would have chosen otherwise, but we chose to look for money in the market because as quantified by Deutsche Bank, the global demand for microfinance loans is about US\$250 billion, where only about 10% of that amount has been lent so far. Resources where needed, and mainstream investors were not easily convinced. Anecdotally we should not forget that as recently as in 2005, Compartamos could not place 100% of a bond in the local market, even with an AA rating and a partial guaranty by the IFC. Funding choices might seem easy, but they were not. Savings would have been ideal, but at that time impossible for regulatory reasons.²⁸

Under the circumstances of a new industry which the market interprets as uncharted territory, we are convinced above average profits²⁹ are necessary to draw in investors and competition³⁰. In an article for Forbes Magazine, Michael Chu writes: "*In fact, humanity has found only one way to deliver consistently and simultaneously the four attributes of scale, permanence, efficacy and efficiency, and it is through private enterprise. This is the result not of any single firm – individual enterprises are born, prosper and die – but of the emergence of an entire industry. And industries are born out of the union of two factors: an economic activity and above average returns*"³¹ We understand very well that people are skeptical when they hear any company wanting to draw in competition, but that is exactly what we wanted. And that is what we got.

In 2006, a study by Claudio Gonzalez-Vega commissioned by CIDE and USAID concluded: "*The (mexican) microfinance sector is experimenting rapid growth. There is significant growth in the number of institutions, as well as in the number of clients... The industry has attracted different actors, from commercial banks interested in the sector to credit bureaus who serve the institutions. The growing number of MFI's and*

²⁷ Focus Note No. 42 CGAP Reflections on the Compartamos IPO: a case study on microfinance interest rates and profits. CGAP, 2008

²⁸ Mexican banking regulations do not allow a non-bank to accept savings from the public.

²⁹ Actually, at the time of the IPO, the two largest, most established banks in Mexico provided a 30% and 29% ROE respectively. Source: CNBV Reports

³⁰ In recent years many industries have been built by the pioneers drawing in above average returns; biotech, and the internet among them.

³¹ Profit and Poverty: why it matters, Michael Chu, Forbes November 5, 2007.

http://www.forbes.com/2007/12/20/michael-chu-microfinance-biz-cz_mc_1220chu.html



the entrance of other institutions, like commercial banks and consumer lending companies have increased competition and forced the institutions to search for better products and to improve their processes³².

In fact, the Mexican Microfinance Network Prodesarrollo, founded a decade ago with 12 institutions (among them Compartamos), now brings together more than 80 institutions serving more than 2 million clients. In the past years, Mexico has seen 8 new regulated commercial banks serving low income clients like: Banco Azteca, BAM, Banco Fácil, BanCoppel, Banco Ahorro Famsa, Banco Amigo, Banco Deuno and more recently Banco Wal-mart. The idea that there is no competition where Compartamos works today is entirely fictional. Globally, this adds to the influx of commercial finance for the industry. According to the Microfinance Bulletin “over the period institutions in the region (LAC) attracted the bulk of all new global commercial debt, totaling 1.2 billion USD of the additional 2.5 billion USD in commercial borrowings on MFI balance sheets at the end of 2006. Asian MFI's accounted for much of the rest”³³.

Additionally, in the Banana Skins Survey, most practitioners felt significant growth and pressure from competition: “They were particularly concerned about competition from ‘outsiders’, i.e. commercial banks entering the sector, or new MFI's established by commercial investors. The growth of competition was blamed, ironically, on the commercial success achieved by many MFI's, and the strong appeal of flotations such as Compartamos in Mexico”³⁴.

However, this is not only a promise that competition will make for more and better products at better prices in the future. Better pricing has already happened, and the trend should continue into the future. The interest rates of Compartamos are an example of this: in the past 7 years, interest rates have dropped from 115% to 79%, a 31% decline³⁵. So the benefits for the client are in the present, not in the future. However, had we limited our average profitability back in 2000, our growth would have stalled significantly and our interest rates would be higher than the one we offer today. We also speculate that it would be a much smaller, much less competed market.

It should be obvious that the levels of return achieved in the IPO for the original investors were exceptional and driven by many factors³⁶, and one can speculate that they will hardly be seen again in future MFI flotations. However, it proved the willingness of capital markets to invest in the future growth of the industry and perhaps more importantly, it sent strong signals to the private sector and entrepreneurial class that microfinance was worth pursuing. As one of our current competitors, Mauricio Hubard, from En Confianza Microfinanciera, has said: “Yunus opened the eyes of the world to microfinance. Compartamos opened the eyes of the private sector and the financial markets. Thanks to the success of their IPO, we were

³² Los Mercados de las Finanzas Rurales y Populares en México: una visión global rápida sobre su multiplicidad y alcance. El sector de las microfinanzas en México. Carlos A. Alpízar y Claudio González-Vega. Proyecto Afirma, 2006

³³ Blaine Stephens, Chief Operating Officer and Director of Analysis, MIX from Bulleting Highlights, Microbanking Bulletin Spring 2008

³⁴ David Lascelles, Center for the Study of Financial Innovation. Microbanking Bulletin, Spring 2008, Feature Articles, Microfinance Banana Skins

³⁵ Despite some critic's misinformation that interest rates have remained over 100%: “They have kept their interest rates at over 100% for many years” Chuk Waterfield, CEO, MFI Solutions

³⁶ “The success of the Banco Compartamos IPO cannot be explained by a single factor. A variety of favorable conditions at the MFI, country, and international level contributed to the offering's success: Compartamos Bank, the Mexican Microfinance Market, the Mexican Financial Market (scarcity value) and the overall Mexican Environment”. ACCION InSight #23: The Banco Compartamos Initial Public Offering Elisabeth Rhyne, Andres Guimon



successful in raising the initial capital we needed from private sector investors in less than a month. The success of Compartamos, even if people want to make it controversial has changed the financial sector and opened new opportunities for companies with a social commitment.”³⁷

Commercial and business principles also bring about much needed upgrades for the microfinance industry: transparency and accountability³⁸. A public company such as Compartamos has to be ultra-transparent (not only by choice but by regulation) and is held accountable by many (the industry, markets, analysts, raters and regulators). We wish we could see this across the industry.

True transparency and accountability also fosters good corporate governance, where one-man shows are impossible, and leadership that is broad and inclusive, based on the independence of the board of directors. We have been for more than 15 years an open book for everyone to learn from, hosting several hundred people, including academics, competitors and socially minded people. Many have benefited from our transparency. It is somewhat ironic that in fact, our transparency is what sets us up for critique.

We set out to build an industry and we are very proud of what we see today. We understand it does not lack risks or challenges. We are convinced we are at a better place now than we were 10 years ago, and our clients acknowledge this.

WE BELIEVE MICROFINANCE HAS GREAT ECONOMIC VALUE

The methodology to serve low income segments of society developed by MFIs is what has made this industry possible and sustainable. This same methodology is what has enabled Compartamos to create social, economic and human value.

We generate social value by providing access to financial services for as many people as we can in the least amount of time. We create economic value by building a profitable and strong company where private capital can participate, making this industry attractive for others to compete in providing better financial services for low income people. We also generate human value by believing in people, by giving credit to their word and their willingness to succeed and realize their capacities, and by encouraging them to be better persons. Not only do we believe these are not contradictory goals, but we are convinced the three reinforce each other.

But one thing needs to be pointed out: the only reason Compartamos has been able to create economic value, is because of the social value created by this financial and working methodology. Therefore, if we fail to create Social value in the lives of our clients, we would then be unable to create Economic value for investors and shareholders.

We believe investors, social or otherwise, are sensible people who understand that any business is built on adding value to client's lives. In a free market economy, companies that are unable to do so die very fast. We acknowledge it is our duty and role to make sure all of our shareholders understand and share this.

³⁷ www.mejorenconfianza.com.

³⁸ Some of our critics seem to be confused about this, believing that “some MFI’s like Compartamos do not yet face market pressures or legal requirements to disclose the information that both investors and impoverished borrowers need in order to make the best choices” Microloan Sharks, Jonathan C. Lewis, Stanford Social Innovation Review, Summer 2008.



Experience shows that our clients derive a positive net benefit by borrowing from Compartamos. In a recent survey done by Ipsos Loyalty, Compartamos scored a 74 on a 0 to 100 scale on client loyalty compared to a 48 average for the banking industry in Mexico. We are convinced the social value of providing opportunities through the access to financial services (and other intangibles) is what drives the creation of economic value. To foster economic value, we must first make sure we keep creating social value.

WE BELIEVE THE CHALLENGE IS MUCH LARGER THAN MICROFINANCE ITSELF

Microfinance has already made a significant contribution in the last twenty years; however it reaches only a small proportion of the potential universe of low income people. Studies vary on the extent of this global shortage some quantifying that only 3.2%³⁹ of potential microfinance clients are served today, while others estimating this number is at most 10-15%⁴⁰. In order for microfinance to fulfill its social mission it is clear it must be scaled up by several orders of magnitude. This can only be accomplished by encouraging large scale private investor participation with a commercial objective. The realization that the "market failure" -first identified by Mr. Yunus-, can be remedied by the know-how developed by MFIs, has led investors, social and otherwise, to realize the potential business opportunity of doing it.

We agree with Mr. Yunus: "*Almost all social and economic problems of the world will be addressed through social businesses. The challenge is to innovate business models and apply them to produce desired social results cost-effectively and efficiently. Healthcare for the poor, financial services for the poor, information technology for the poor, education and training for the poor, marketing for the poor, renewable energy – these are all exciting areas for social businesses*"⁴¹. However, we still grapple with the notion of a non-loss, non-dividend company: "*Investors in the social business could get back their investment, but will not take any dividend from the company... A social business will be a non-loss, non-dividend company*"⁴². Maybe some would view this as an ideal state but we don't, and we acknowledge our inability to change modern economics.

Many disagree that social and economic goals can reinforce each other, among them Chuck Waterfield: "*The fundamental issue in multiple bottom lines is that we need to understand how to strike some acceptable balance between challenging and contradictory goals*"⁴³. However, as we argue, these goals are not contradictory and the experts behind The Pocantico Declaration agree: "*We find hope in the continued growth of microfinance and the expansion of services provided to poor and low income people. We are encouraged that in many areas an increase in competition and the application of new technologies are bringing down transaction costs leading to lower prices for our clients. We look forward to the increased provision of savings services to the poor and the expansion of domestic capital markets. We support the expanding connections between microfinance, other sectors of the economy and other*

³⁹ "GCAP: Helping Build a Microfinance Industry" available at <http://www.gdrc.org/icm/cgap-mfindustry.html>

⁴⁰ Paul DiLeo and David FitzHerbert, "The Investment Opportunity in Microfinance", Grassroots Capital Management, LLC, June 2007.

⁴¹ Muhammad Yunus, Nobel Prize Acceptance Speech, Oslo, December 2006

⁴² Muhammad Yunus, Nobel Prize Acceptance Speech, Oslo, December 2006

⁴³ 25th. June, Chuck Waterfield CEO, MFI Solutions



*development efforts*⁴⁴. However, we are fully aware and respect the fact that there isn't agreement on the appropriate levels and use of profits to achieve this.

As Alvaro Rodriguez, Chairman of Accion International writes: "*I think the question should not be what microfinance is about; the question should be what is it that we need to eradicate poverty. If the answer to this second question is that we need to develop commercially viable enterprises that serve the poor, then that is one of the initiatives we should pursue*"⁴⁵. By building Compartamos, we have tried to put forth an initiative, and we are sure it is not the only one that will work. We therefore encourage others to follow in the pursuit of other initiatives, by other means.

Everybody agrees that MFIs are going through a period of deep and important change. There is no question that the debate will continue. This letter is merely a contribution to better understand our point of view in the debate. In the end, the ability to expand the market and include large numbers of excluded low income people into the financial sector, will give us all a better perspective on the benefits of the commercialization of microfinance.

These are our beliefs. We did not write this paper to convince anyone of our model, but rather, to let our peers know what we stand for. We are sure the readers, after reading this, will stand for their own beliefs.

We encourage you to send us your comments to alettertoourpeers@compartamos.com

⁴⁴ The Pocantico Declaration, April 2008. www.microfinancegateway.org/content/article/detail/49313

⁴⁵ Alvaro Rodriguez, Commercial Microfinance: the case of Compartamos. UBS Philanthropy, Spring 2008

TABLE 1

Table 1															
	Number of Active Borrowers	Percent of Women Borrowers	Gross Loan Portfolio (in US\$)	Average Loan Balance per Borrower (US\$)	Average Loan Balance per Borrower (US\$)/GNI per Capita	Yield on Gross Portfolio	Return on Equity	Total Expense Ratio	Financial Expense Ratio	Loan Loss Provision Expense Ratio	Operating Expense Ratio	Average Salary/GNI per Capita	Cost per Borrower	Borrowers per Staff Member	
1	ALSOL	13,753	N/A	2,211,262	161	2.04%	62%	42%	32%	N/A	N/A	28.0%	N/A	64	N/A
	CAME	87,840	N/A	14,811,354	169	2.14%	104%	-10%	64%	N/A	N/A	58.0%	N/A	167	N/A
	ESPACIOS ALTERNATIVOS	639	N/A	86,030	135	1.71%	76%	100%	68%	N/A	N/A	62.0%	N/A	375	N/A
	FINCA MEXICO	73,346	N/A	17,858,718	243	3.09%	82%	24%	52%	N/A	N/A	42.0%	N/A	144	N/A
	FINCOMUN	36,800	N/A	32,514,468	884	11.23%	84%	160%	50%	N/A	N/A	40.0%	N/A	528	N/A
	FORJADORES	6,742	N/A	1,528,349	227	2.88%	102%	80%	78%	N/A	N/A	68.0%	N/A	197	N/A
	PROMUJER MEXICO	16,924	N/A	4,214,288	249	3.16%	64%	100%	50%	N/A	N/A	42.0%	N/A	133	N/A
	SOLFI	16,898	N/A	3,515,295	208	2.64%	100%	140%	72%	N/A	N/A	62.0%	N/A	160	N/A
2	FINSOL	302,158	N/A	119,759,787	396	5.04%	79%	32%	N/A	N/A	N/A	N/A	N/A	148	N/A
3	COMPARTAMOS	838,754	98%	377,831,412	450	5.72%	79%	46%	39%	8.4%	1.7%	29.0%	2.15	152	196
4	All MFI's	16,026	64%	8,103,621	563	44.50%	32%	8%	25%	6.7%	1.5%	15.3%	4.50	116	125
	Methodology - Village Banking	17,390	95%	4,372,202	183	17.20%	45%	9%	35%	6.8%	1.1%	25.9%	3.70	64	155
	Profit Status - For Profit	32,485	54%	20,527,922	725	64.00%	31%	8%	23%	6.7%	1.5%	14.4%	6.40	147	114
	Profit Status - Not for Profit	10,947	69%	6,082,881	551	37.50%	32%	9%	26%	6.7%	1.5%	16.2%	4.20	111	127
	Target Market- Low end	18,463	92%	5,229,552	145	14.30%	39%	7%	29%	0.1%	1.5%	21.9%	2.90	49	160
	Regional - Asia Large	141,957	98%	19,304,827	139	21.60%	28%	12%	20%	6.5%	1.1%	11.4%	3.20	29	158
	Regional - LAC Large	55,093	54%	55,271,789	1,322	54.80%	30%	21%	22%	7.6%	1.6%	13.2%	5.00	174	135

1 All figures are extracted from www.prodesarrollo.com.mx the official site for Prodesarrollo, the Mexican Microfinance Network. Figures are for June 2007, annualized

2 Most figures are extracted from the audited Financial Statements for 2007 posted in the Company's website www.finsol.com.mx. Number of clients is estimated by different sources. PAR is >90 days

3 All figures are extracted from the MIX Market website www.mixmarket.org for 2007

4 All figures are extracted from the MIX Microbanking Bulletin Spring 2008 with data for 2006



TABLE 2

Region	Country	# MFIs	Inequality Comparisons ¹						PPP Comparisons ¹								
			Loan Balance (% GNI per capita)		Loan Balance (% GNI poorest 40%)		Loan Balance \$	GNI per capita	GNI 40%		Income Share 40%	Loan Balance (% GNI per capita)	Loan Balance PPP dollars	Ranking ³	PPP	Ranking	GNI per capita PPP
			%	Ranking ²	%	Ranking			315	16.8	31	4	550	9	1,840		
Africa	Senegal	12	31	4	74	4	234	750	315	16.8	31	4	550	9	1,840		
	Zambia	5	33	5	116	11	210	630	181	11.5	33	5	308	3	1,000		
	Ghana	30	45	7	115	9	233	520	203	15.6	45	8	1,089	19	2,640		
	Kenya	15	45	8	114	8	243	580	229	15.8	45	9	515	8	1,300		
	Tanzania	10	45	9	94	6	156	350	169	19.3	45	10	355	4	740		
	Cameroon	6	52	11	140	13	565	1,080	404	15.0	52	13	1,178	21	2,370		
	Mali	10	53	12	129	12	233	440	180	16.4	53	14	568	10	1,130		
	Ethiopia	20	65	13	116	10	117	180	101	22.4	65	15	767	12	1,190		
	Mozambique	8	74	15	201	15	251	340	125	14.7	74	18	892	15	1,220		
	Uganda	14	80	16	212	16	240	300	113	15.1	80	19	1,115	20	1,490		
	Madagascar	9	121	17	363	18	340	280	94	13.4	121	21	1,078	18	960		
	Benin	10	131	18	281	17	706	540	252	18.6	131	23	1,439	23	1,160		
	Rwanda	6	195	20	540	19	488	250	90	14.5	195	26	2,299	26	1,270		
EAP	Philippines	67	11	1	33	1	170	1,420	515	14.5	11	1	644	1	5,980		
	China	5	12	2	37	2	237	2,010	640	12.7	12	2	888	3	7,740		
	Vietnam	5	21	3	47	3	148	690	315	18.3	21	3	694	2	3,300		
	Indonesia	36	42	4	83	4	572	1,420	721	20.3	42	4	1,482	4	3,950		
	Cambodia	14	89	5	208	5	426	480	205	17.1	89	5	2,582	5	2,920		
ECA	Azerbaijan	18	29	1	60	1	531	1,850	877	19.0	29	1	1,530	2	5,960		
	Uzbekistan	9	29	2	61	2	177	610	289	18.9	29	2	630	1	2,250		
	Armenia	9	41	4	78	4	784	1,930	1,006	20.8	41	4	2,134	5	5,890		
	Russia	25	43	5	103	8	2,421	5,780	2,402	16.6	43	5	4,078	9	11,630		
	B & H	15	53	8	90	7	1,594	2,980	1,764	23.7	53						
	Kazakhstan	23	63	9	131	10	2,404	3,790	1,831	19.3	63	8	4,241	10	7,780		
	Georgia	9	67	10	168	11	1,047	1,560	625	16.0	67	9	2,352	6	3,690		
	Tajikistan	20	115	14	226	17	447	390	198	20.3	115	12	1,538	3	1,410		
	Romania	7	115	16	220	14	5,587	4,850	2,539	20.9	115	14	9,130	16	9,820		
	Bulgaria	6	125	17	223	16	4,978	3,990	2,231	22.4	125	15	11,742	17	10,140		
	Kyrgyzstan	31	219	19	403	19	1,063	490	266	21.7	219	17	3,794	8	1,990		
LAC	Mexico	32	5	1	15	1	373	7,870	2,478	12.6	5	1	532	1	11,410		
	Argentina	6	5	2	18	2	245	5,150	1,374	10.7	5	2	711	2	15,390		
	Dominican R.	6	13	3	42	3	357	2,850	841	11.8	13	3	992	6	8,290		
	Brazil	8	13	4	57	5	619	4,730	1,094	9.2	13	4	973	5	8,800		
	Costa Rica	10	14	5	47	4	681	4,980	1,455	11.7	14	5	1,524	10	10,770		
	Guatemala	16	16	6	65	6	425	2,640	657	10.0	16	6	747	3	4,800		
	Colombia	15	27	9	125	12	745	2,740	594	8.7	27	9	1,876	12	7,620		
	Honduras	14	33	10	125	10	394	1,200	316	10.5	33	10	1,143	7	3,540		
	Ecuador	38	33	11	123	9	950	2,840	771	10.9	33	11	1,439	9	4,400		
	Peru	40	36	12	125	11	1,040	2,920	832	11.4	36	12	2,045	14	6,080		
	El Salvador	15	42	13	165	13	1,061	2,540	645	10.2	42	13	2,239	15	5,340		
	Paraguay	6	44	14	202	15	616	1,400	305	8.7	44	14	1,893	13	5,070		
MENA	Haiti	7	66	15	307	16	318	480	103	8.6	66	15	883	4	1,490		
	Nicaragua	26	67	16	174	14	655	1,000	386	15.4	67	16	2,723	16	4,010		
	Bolivia	19	120	17	649	17	1,325	1,100	204	7.4	120	17	3,297	17	2,890		
	Egypt	13	10	1	19	1	134	1,350	697	20.6	10	1	435	2	4,690		
	Morocco	10	14	3	32	3	263	1,900	812	17.1	14	3	675	3	5,000		
S Asia	Jordan	6	41	4	95	4	1,102	2,660	1,164	17.5	41	5	2,599	5	6,210		
	India	79	13	1	26	1	102	820	397	19.4	13	1	463	3	3,800		
	Sri Lanka	13	13	2	31	3	174	1,300	567	17.4	13	2	676	4	5,010		
	Bangladesh	58	16	3	31	2	75	470	243	20.7	16	3	408	1	2,160		
	Pakistan	20	19	4	35	4	134	770	430	22.3	19	4	448	2	2,500		
	Nepal	18	44	5	116	5	127	290	109	15.0	44	5	684	5	1,630		

Source: Based on MFIs reporting to MIX Market or MBB. 2005 used when 2006 not available.

¹ Medians by country.

² Only for countries with Loan Balance standardized by average GNI of the poorest 40 percent available.

³ Only for countries with Loan Balances in PPP dollars available.