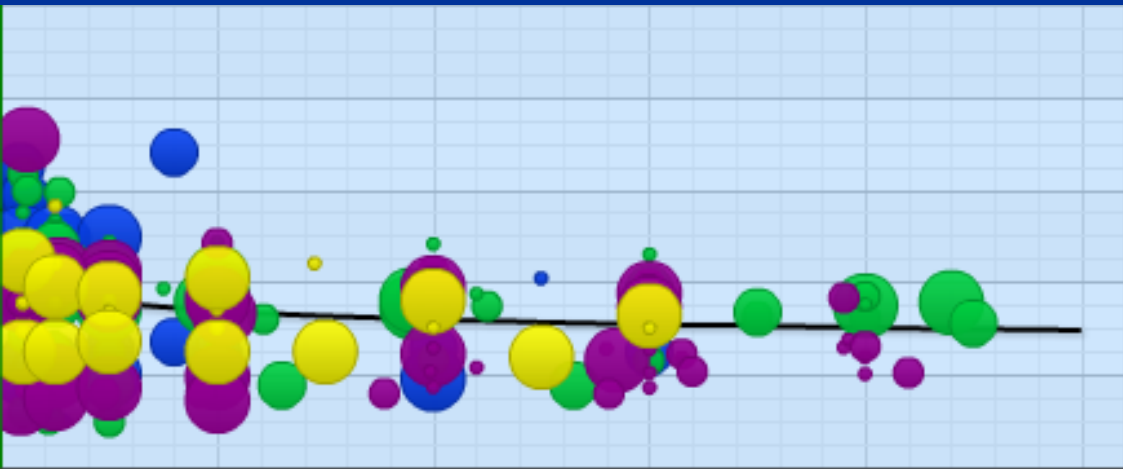


# **Prices, Costs, Profits, and Responsible Practice**

**NPM Seminar**

Chuck Waterfield  
CEO

MicroFinance Transparency  
February 2013

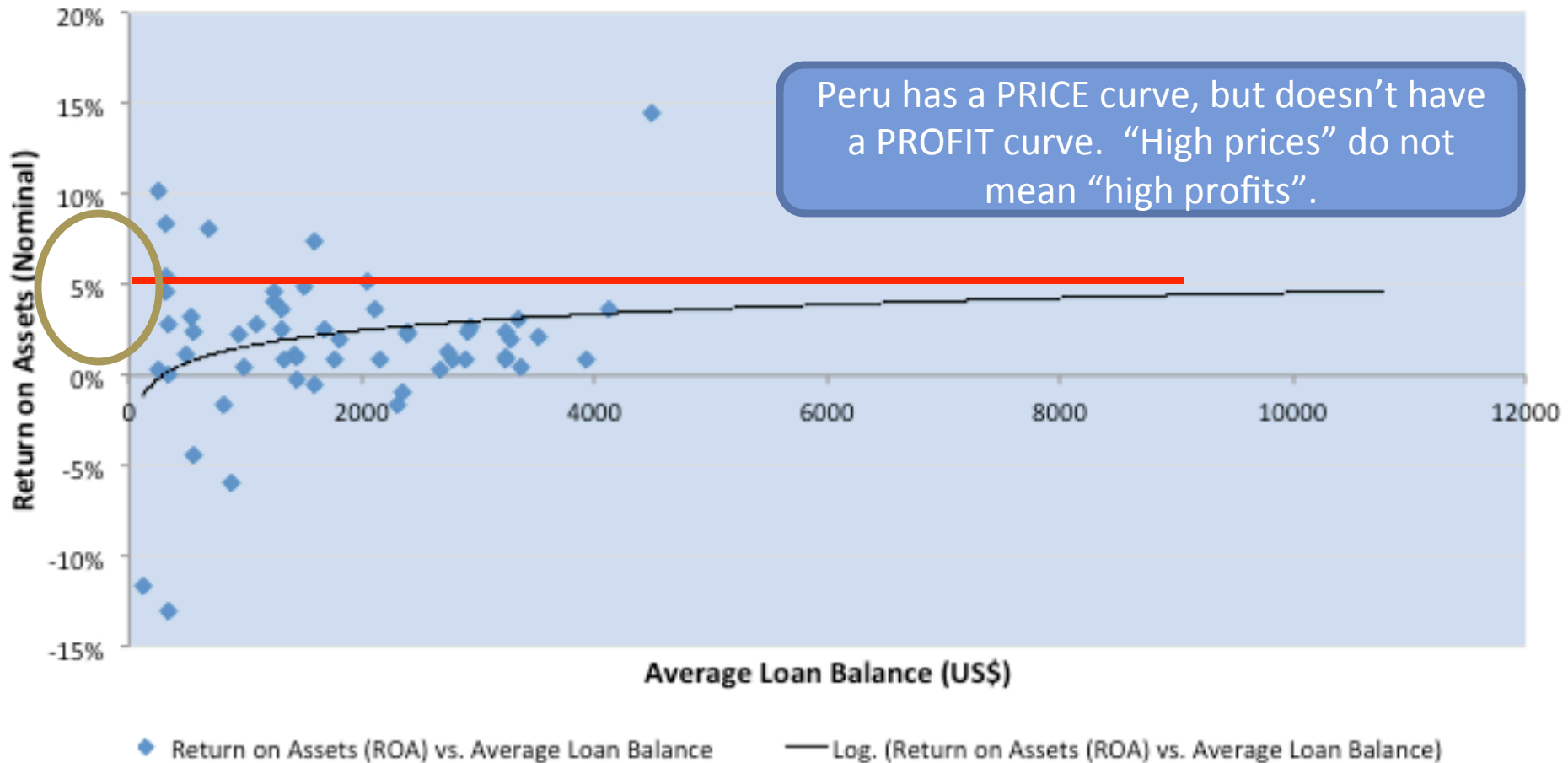


## SECTION 6:

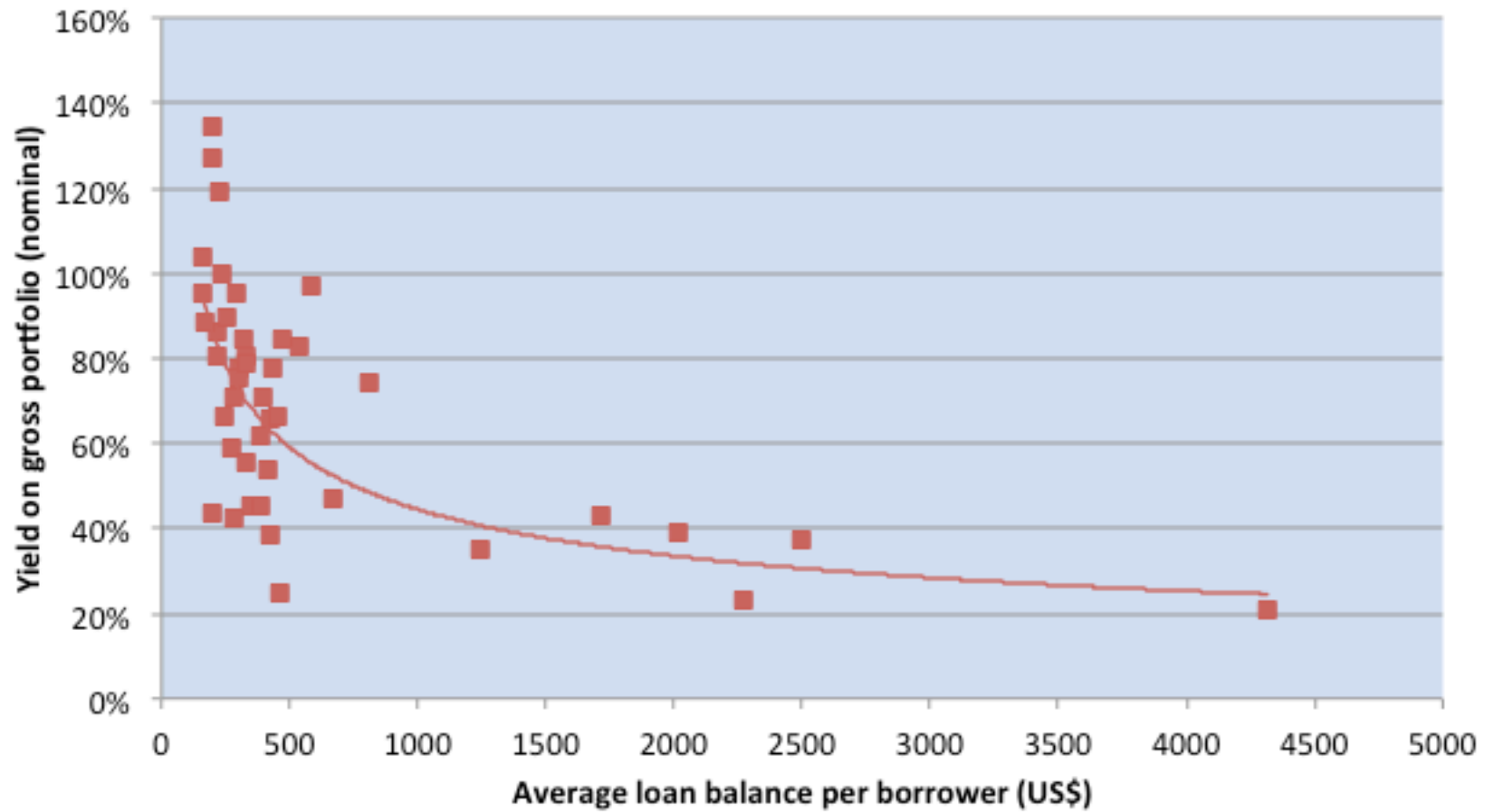
# Prices and Profits

# In Most Countries, Profits not Correlated to Loan Size

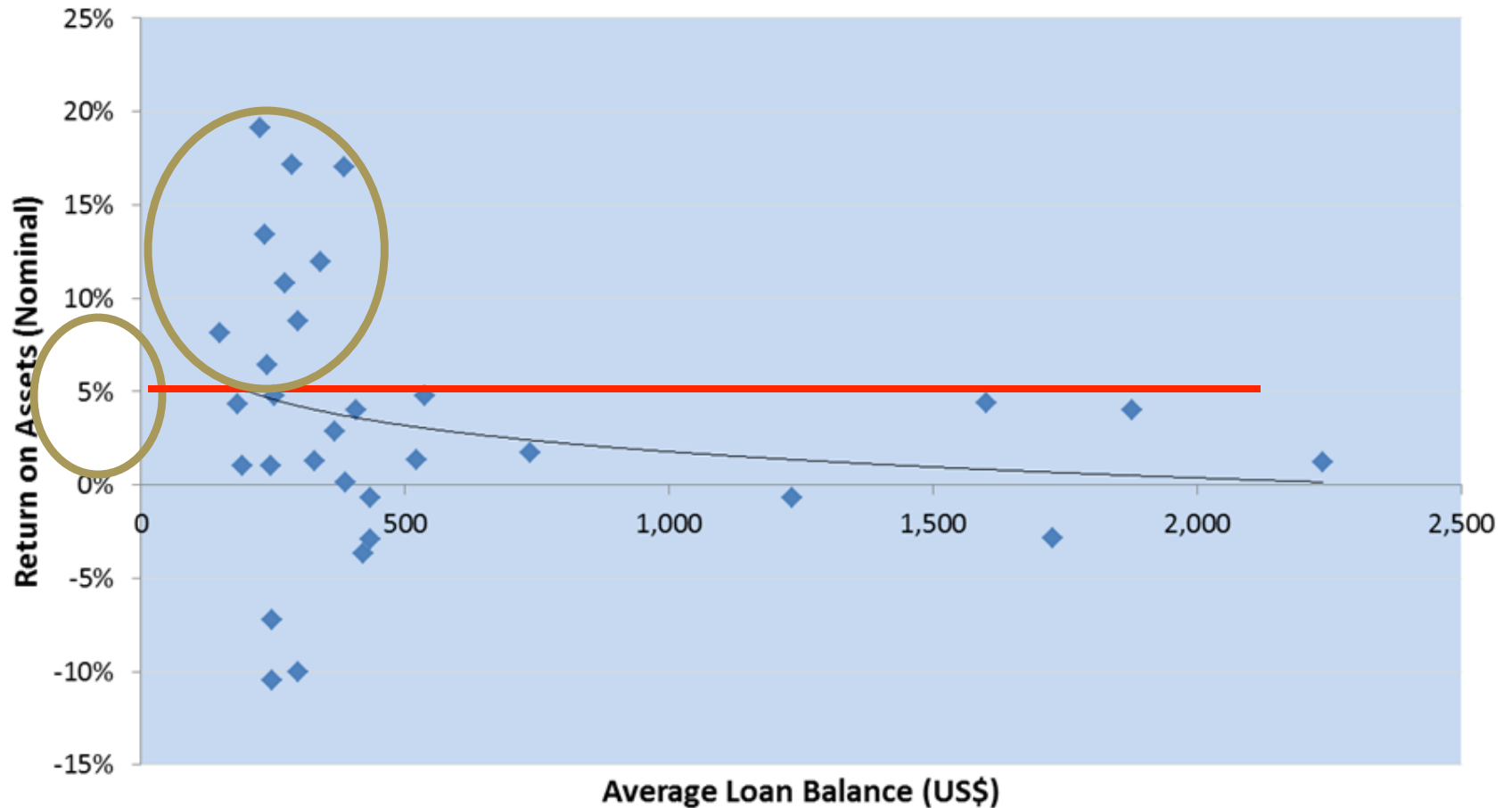
Return on Assets (ROA) vs. Average Loan Balance  
Peru, 59 MFIs



**Yield on gross portfolio (nominal) vs Average loan balance per borrower (US\$)**  
**Data for 51 MFIs in Mexico, 2010**



## Return on Assets (ROA) vs. Average Loan Balance Mexico, 32 MFIs

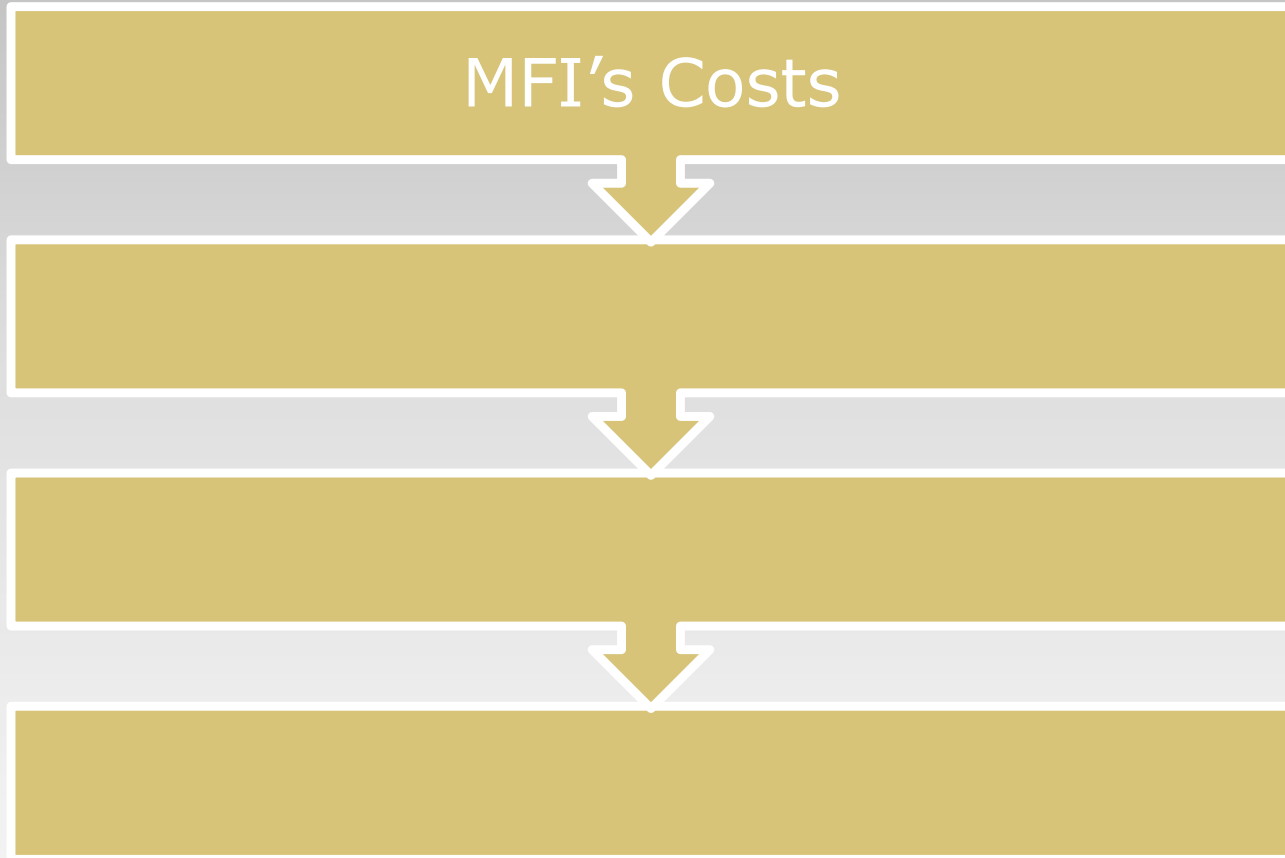


◆ Return on Assets (ROA) vs. Average Loan Balance — Log. (Return on Assets (ROA) vs. Average Loan Balance)

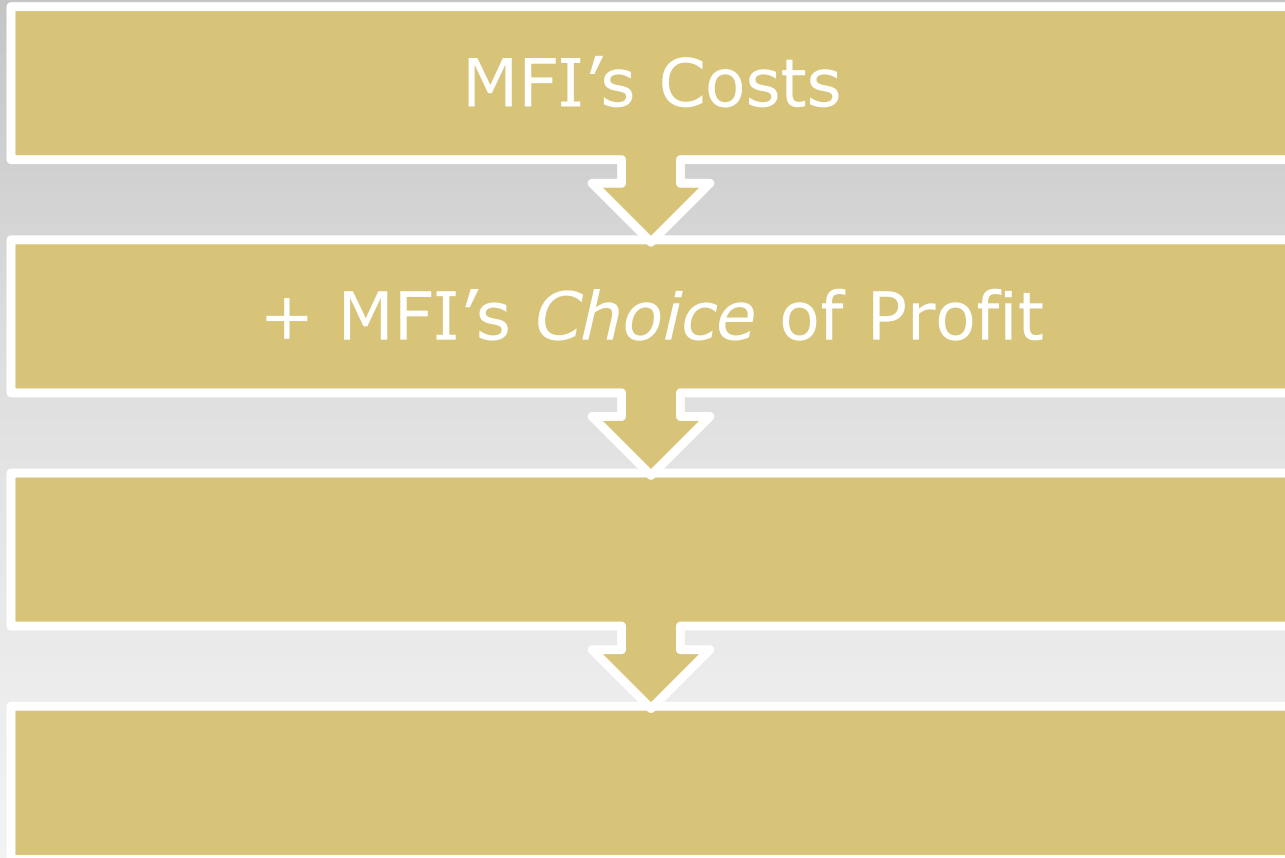
# Mexico MFIs with > US\$1M in profit in 2010

Institution	Profit
CompartamosBanco	\$208M
Financiera Independencia	\$45M
CAME	\$6M
Apoyo Economico	\$6M
FINCA - MEX	\$6M
Invirtiendo	\$4M
Conserva	\$2M
Te Creemos	\$2M
Mas Kapital	\$2M
Solucion Asea	\$2M
FinComun	\$2M
SolFi	\$1M
Forjadores de Negocios	\$1M
<b>Total</b>	<b>\$287M</b>

# Defining a Responsible Price

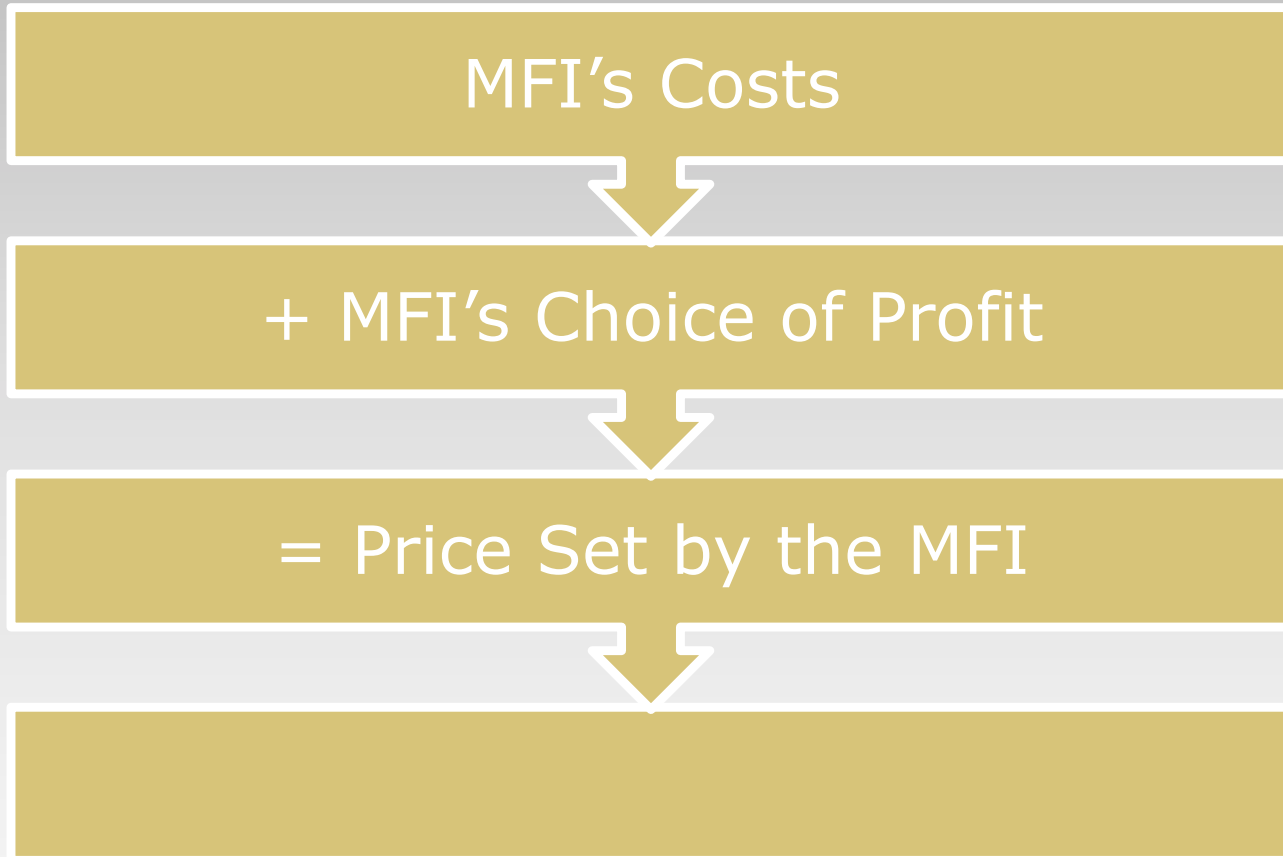


# Defining a Responsible Price

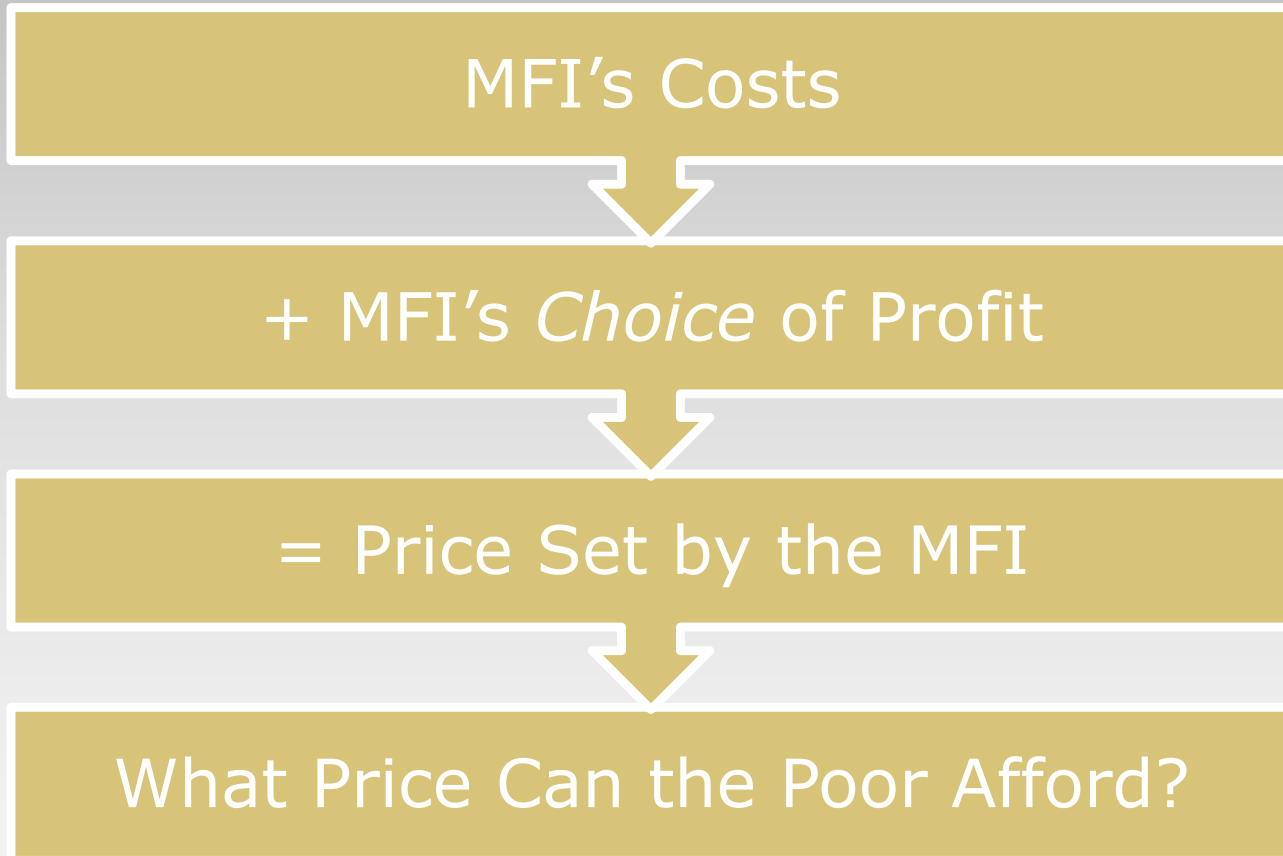




# Defining a Responsible Price

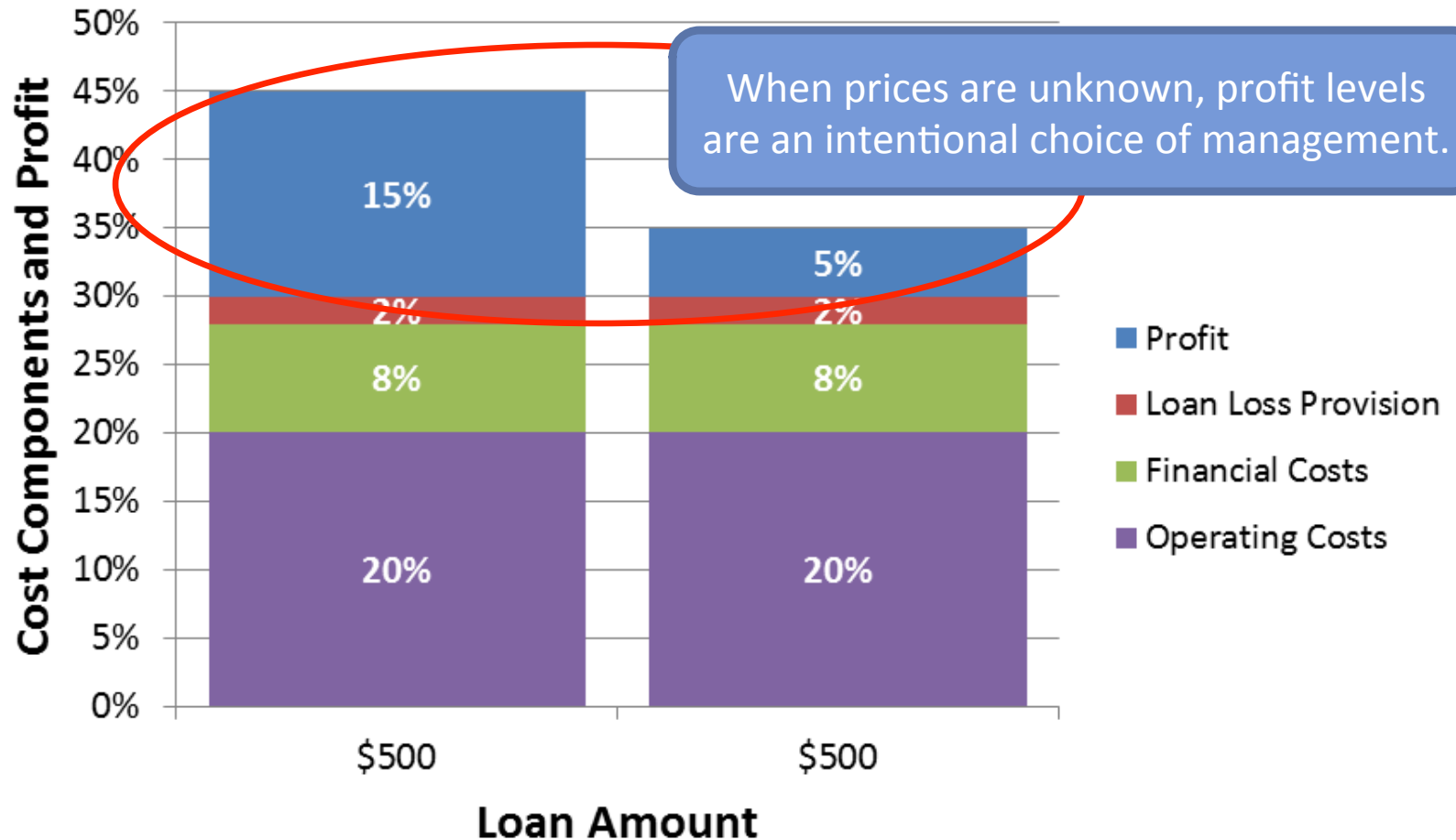


# Defining a Responsible Price



# The Profit/(Loss) Component is the *Choice* of Management

## Pricing Decisions



## SECTION 8:

# Rating MFIs on their Pricing Transparency

# Transparent Communication

- **Product Transparency Index**
  - The relation of nominal interest rate to Full APR
- **Institutional Transparency Index**
  - Weighted average of all Product Transparency Indices
- **Contract and Repayment Schedules**
  - Do they communicate the price clearly to the client?
- **Transparent communication to all stakeholders**
  - What prices are communicated in other public materials?
  - What prices are communicated to the press?

# Transparency Must Come First

**Transparent Pricing**



**Responsible Pricing**

Definition &  
Discussion

Implementation

# The need for self-regulation

1. Do we need external regulation?
  1. Appropriate regulation is essential to a well-functioning market
  2. Regulation reduces risks and market volatility
2. Do we also “need” self-regulation?
  1. Going beyond the minimum legal requirements helps distinguish responsible practice from ordinary practice

# Combined Approach

Self Regulated  
Practice of  
Transparent  
Pricing

Supportive  
Government  
Regulation

Responsible  
Pricing



# What does transparency mean for responsible pricing?

No transparency = less competition



Less competition = wider range in prices



We improve transparency and price competition...



**Competitive prices = Responsible prices**

# Example 1: Cambodia

## Interest Rates

- Must be disclosed
- Charging flat interest rates prohibited

## Pricing Information

- Information about prices must be published on MFI websites

# Example 2: Bosnia

## Interest Rates

- Compounding calculations required
- Must be included on loan contract and repayment schedule

## Reporting

- Prices by product must be reported to regulators

## Pricing Information

- Information about prices must be published on MFI website

# Example 3: Peru

## Interest Rates

- Interest rates must be disclosed

## Reporting

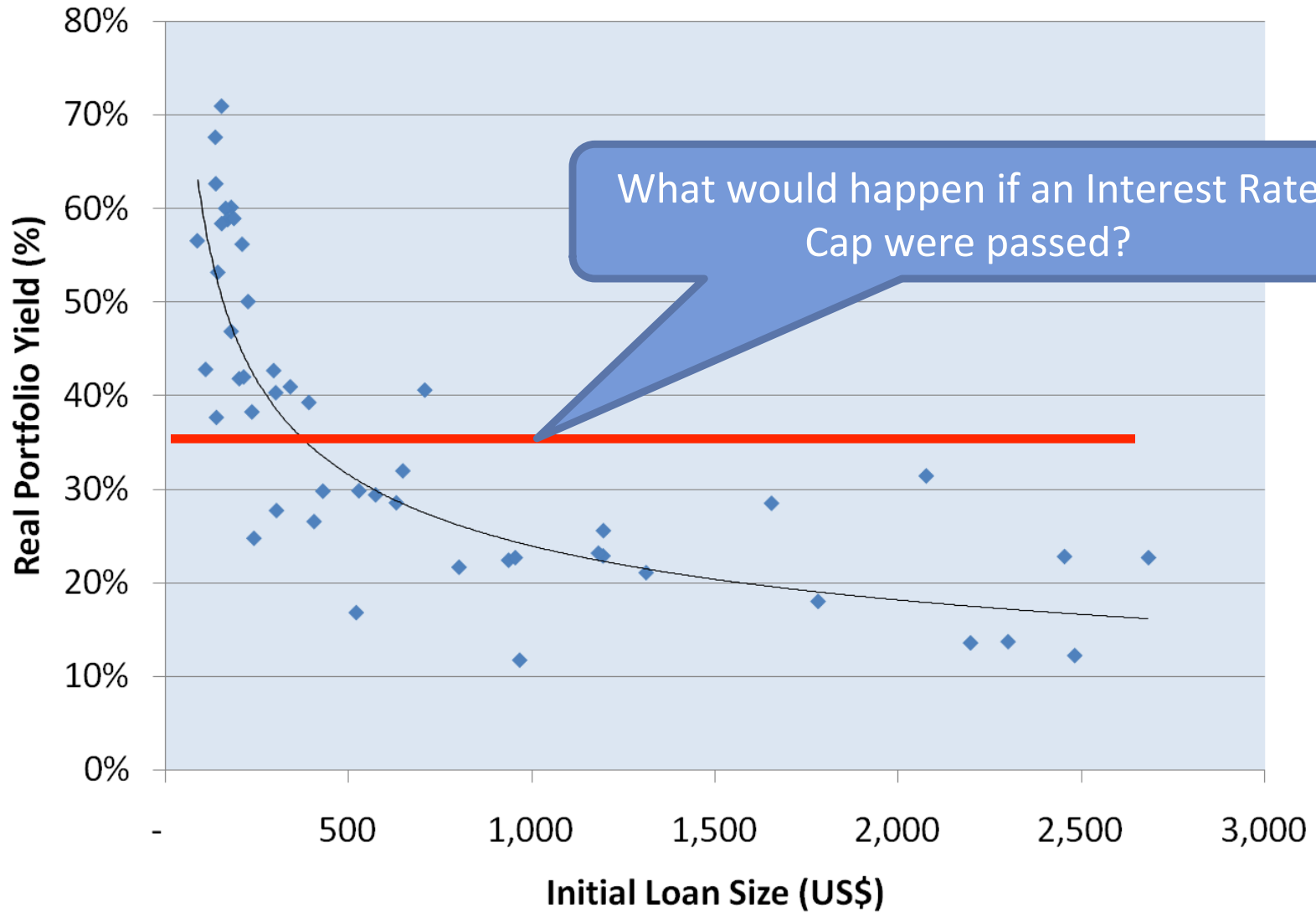
- Prices by product must be reported to regulator

## Pricing Information

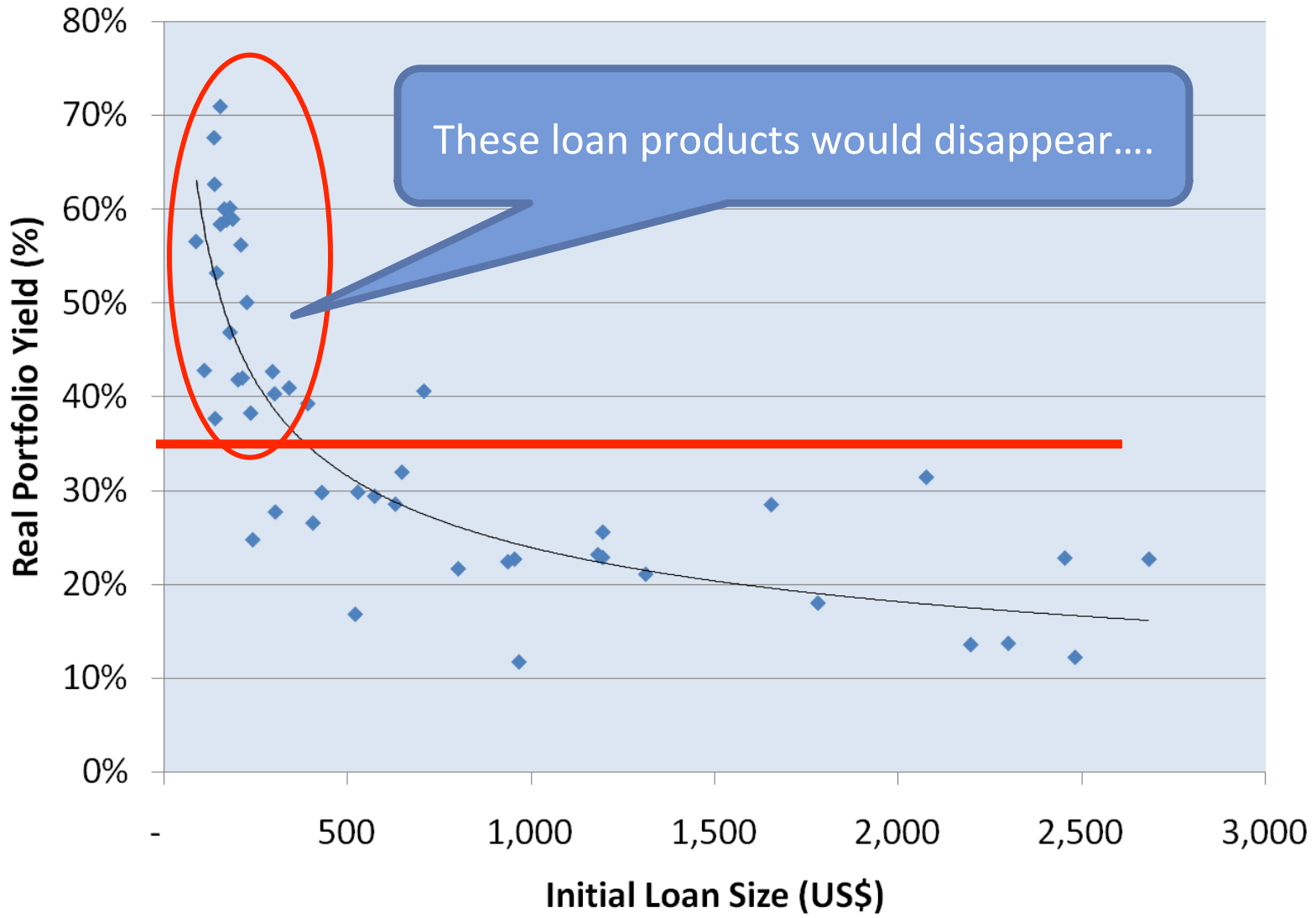
- All fees and insurance charges must be disclosed
- Information about prices must be published on the MFI website

# Loan Size and Real Portfolio Yield

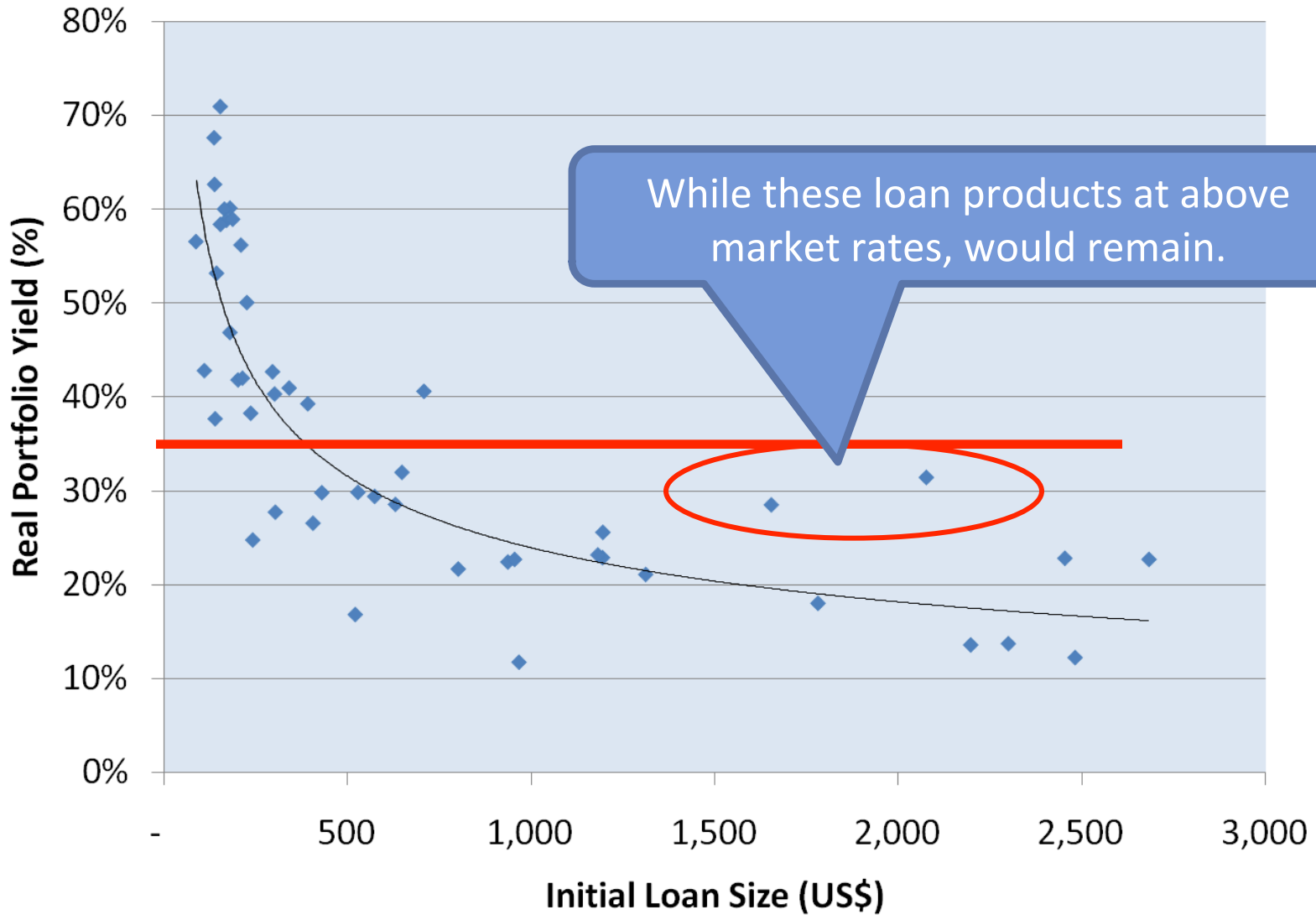
(48 MFIs in Philippines)



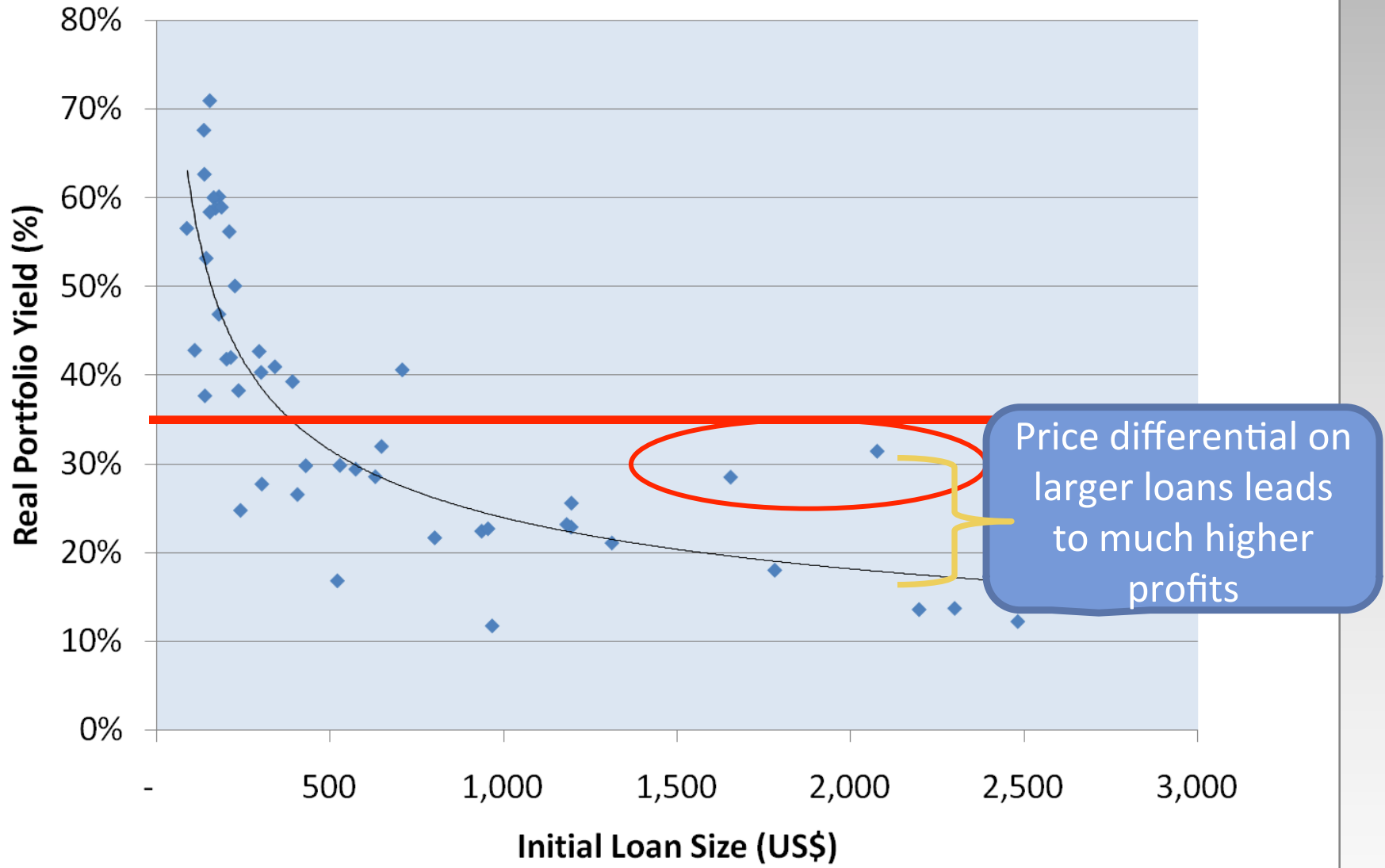
# Loan Size and Real Portfolio Yield (48 MFIs in Philippines)



# Loan Size and Real Portfolio Yield (48 MFIs in Philippines)

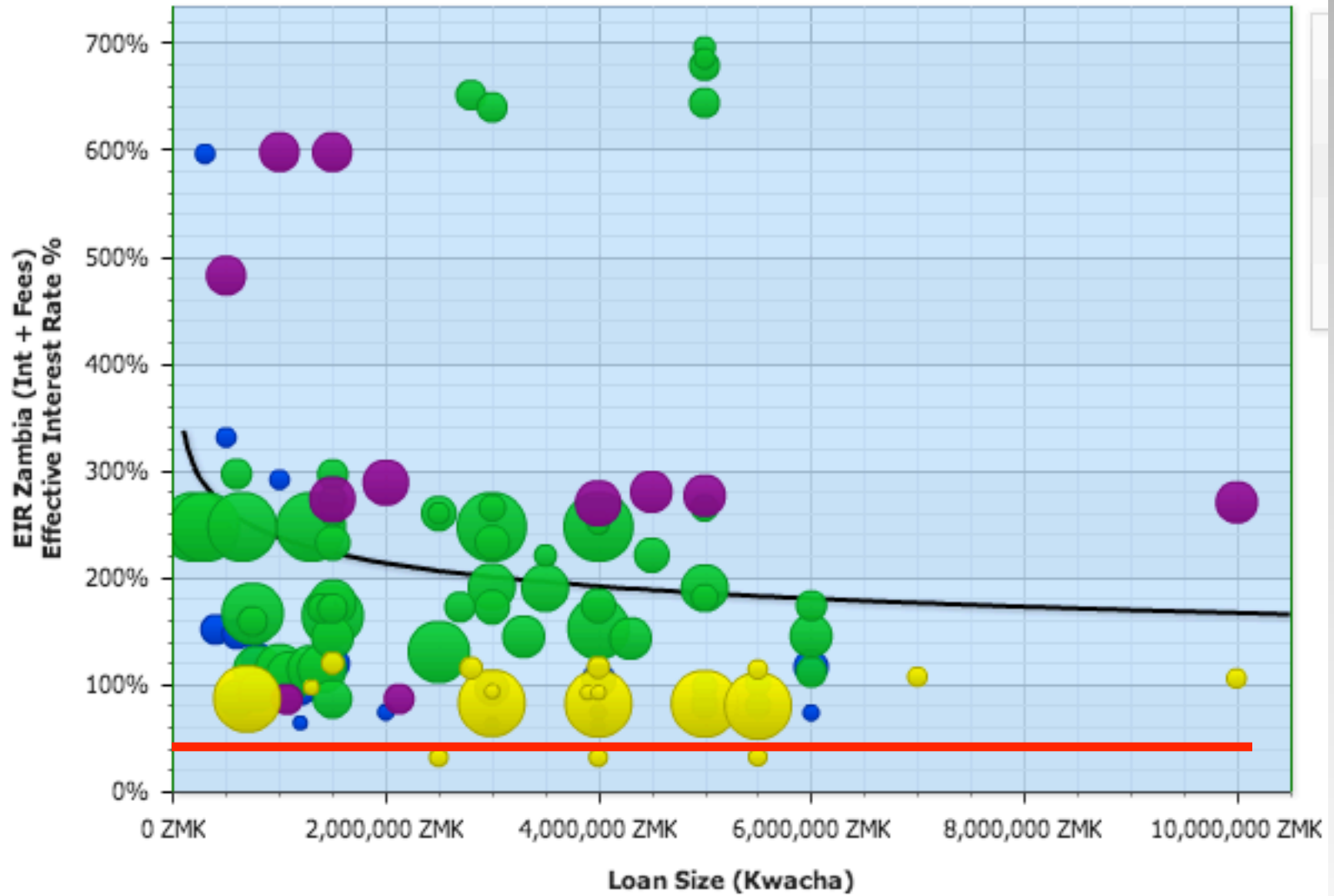


# Loan Size and Real Portfolio Yield (48 MFIs in Philippines)



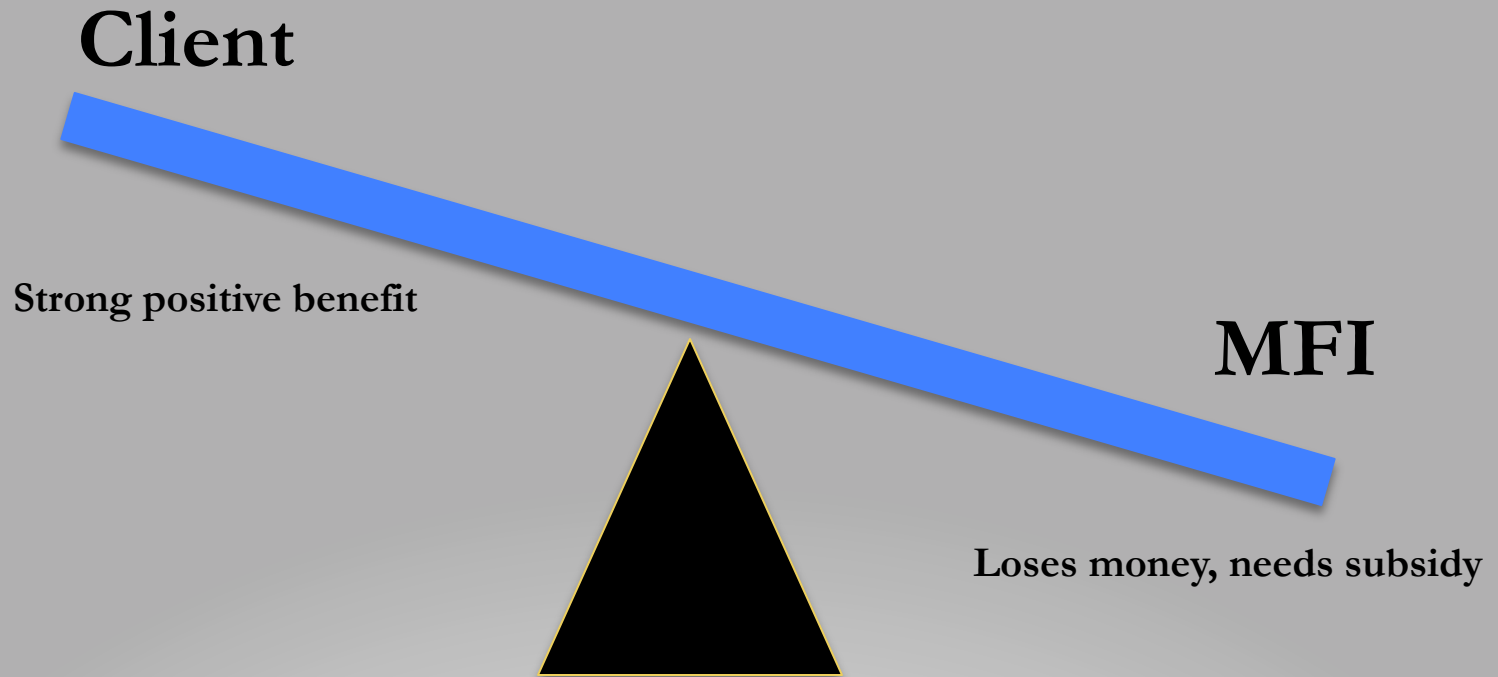


Product Size vs Interest Rate (Zambia)



# Profitability: Zero-Sum and Double-Bottom Line

# Social Project – The client is given priority

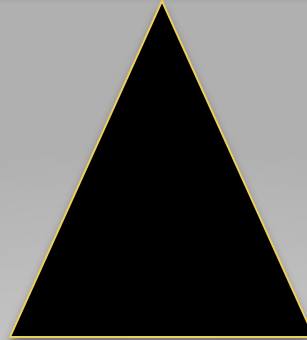
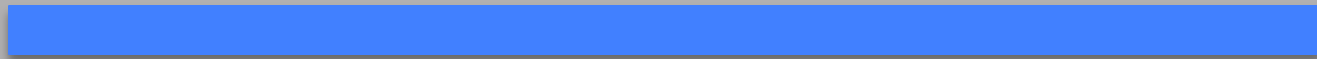


# Double Bottom Line –

There is a balance between business and client

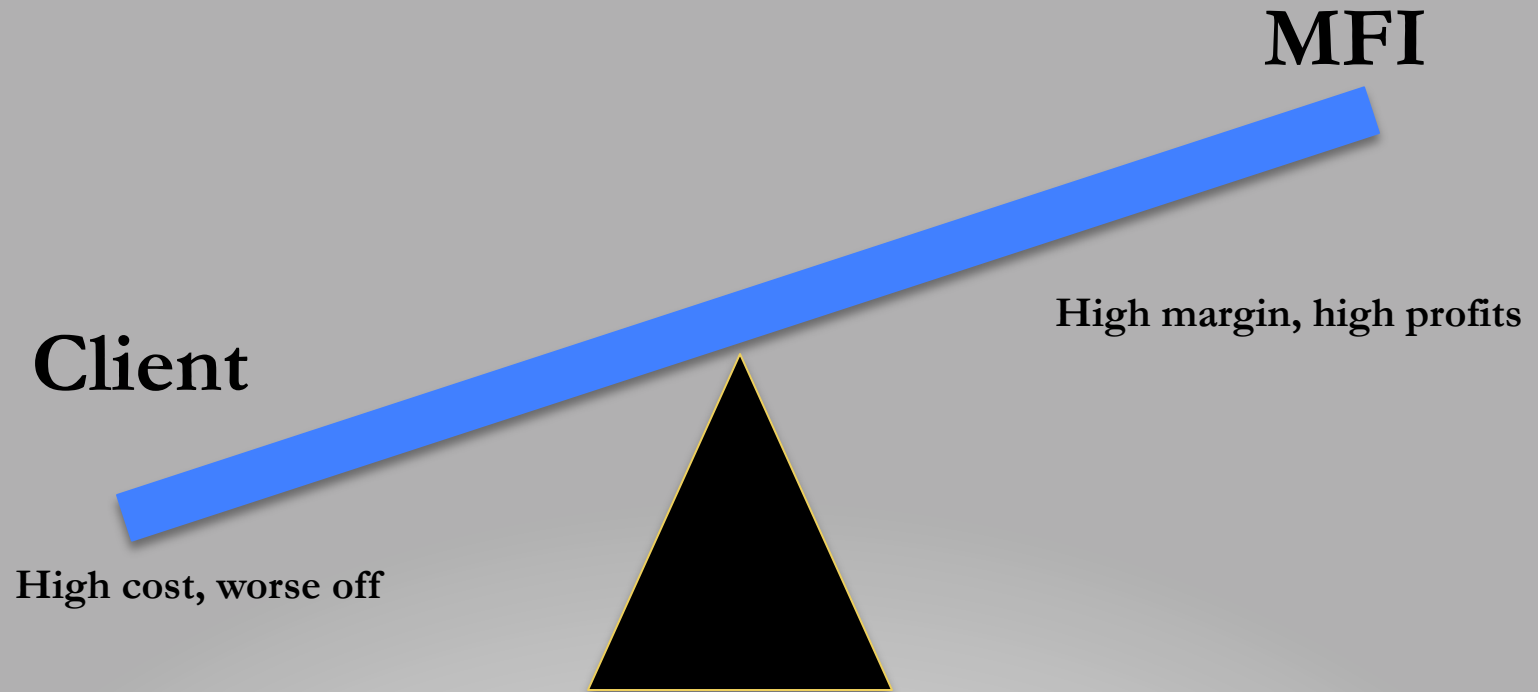
Client

MFI



Ideally, we seek a “win-win” in which both the client and the MFI benefit

# Profit Maximizing – The business exerts full power



# This is a Zero-Sum Situation

## Money does not just materialize from nowhere

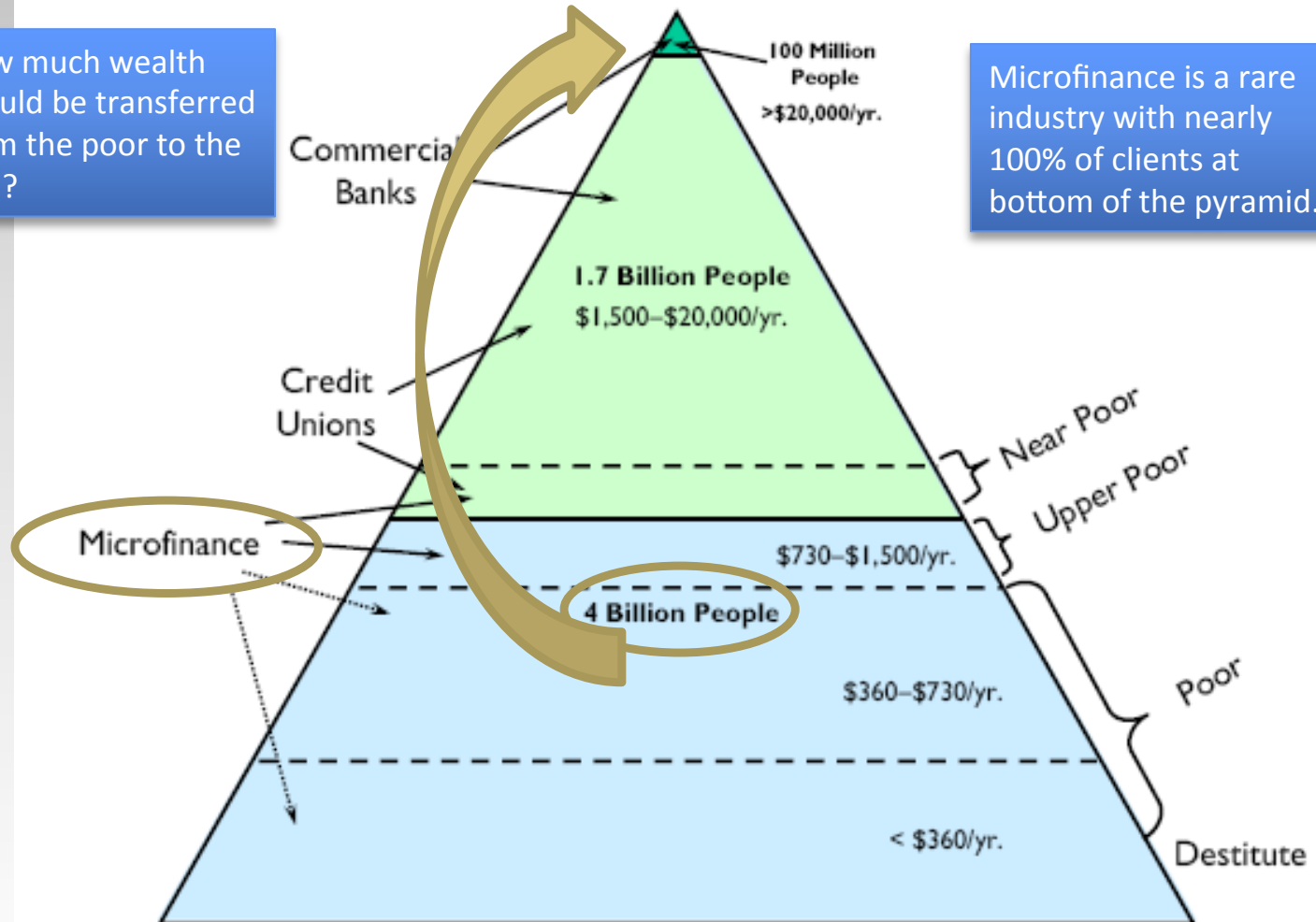
- Every penny of profit the MFI makes comes from the pockets of the clients
- Our clients are from the Bottom of the Pyramid. They are poor, and mostly female
- At some point, the MFI's profit absorbs all the economic impact the client received from the loan. The MFI's shareholders are wealthier, and the clients are poorer

# The Income Distribution Pyramid

## Microfinance Can Reach the Lower Income Levels

How much wealth should be transferred from the poor to the rich?

Microfinance is a rare industry with nearly 100% of clients at bottom of the pyramid.



\*Sources: VISA International, World Bank, C.K. Pralahad

# Transparency Must Come First

**Transparent Pricing**



**Responsible Pricing**

Definition &  
Discussion

Implementation



# Combined Approach

Self Regulated  
Practice of  
Transparent  
Pricing

Supportive  
Government  
Regulation

Responsible  
Pricing

# How can transparency affect pricing?

Prices become known

MFIs on the high side lower prices,  
MFIs on the low side raise prices

Prices become more uniform, follow  
the curve

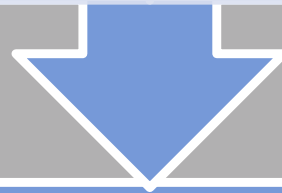
We anticipate that the average price  
in a market will drop.

# Results of Non-Transparent Pricing

MFIs do not compete on price but on other factors

Prices therefore can and do vary dramatically

Some MFIs push prices higher to maximize profits



Consumers are often told a much lower price than reality

Consumers buy more expensive loans

Consumers go into more debt than they should

# We need to choose and define responsible practice

1. The temptation of large profits can lead some to irresponsible practice
2. Irresponsible practice leads to client abuse
3. Our obligation is to self-regulate the industry and promote responsible practice
4. Doing so protects both the poor and the industry

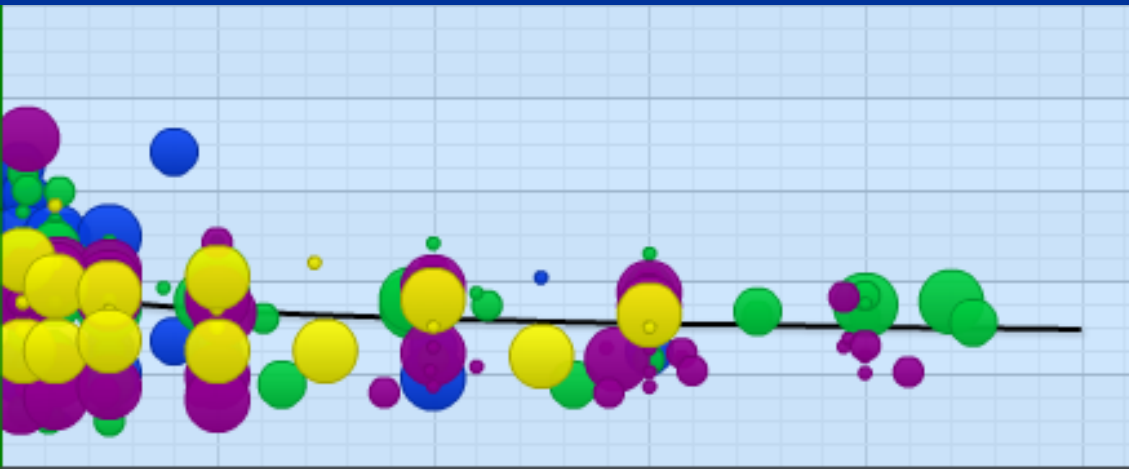
mftransparency.org

*Promoting Transparent Pricing in the Microfinance Industry*

# Standards for Responsible Finance

Nairobi

October 2011



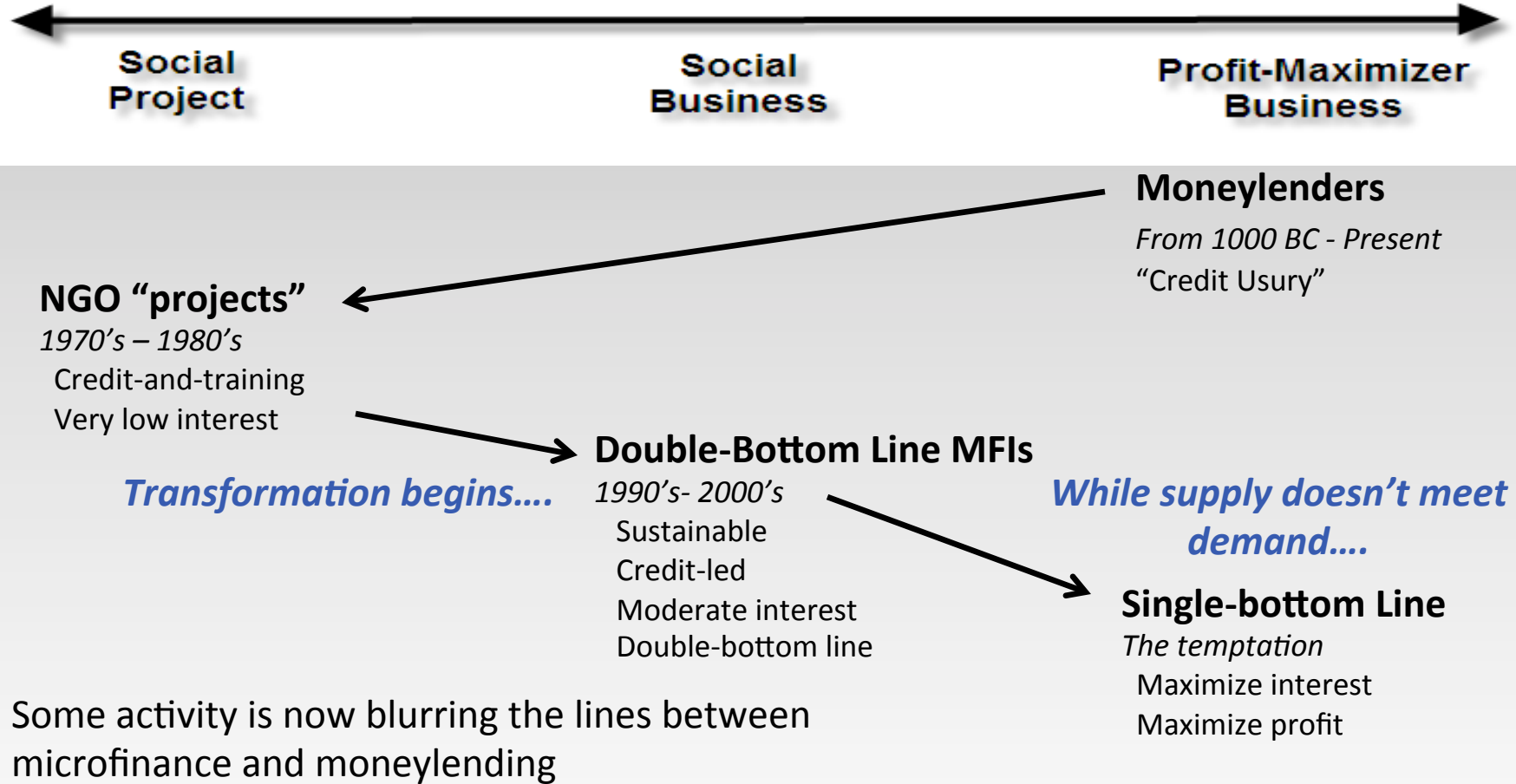
# Responsible Finance: Two foundational questions

**How?**

**Why?**

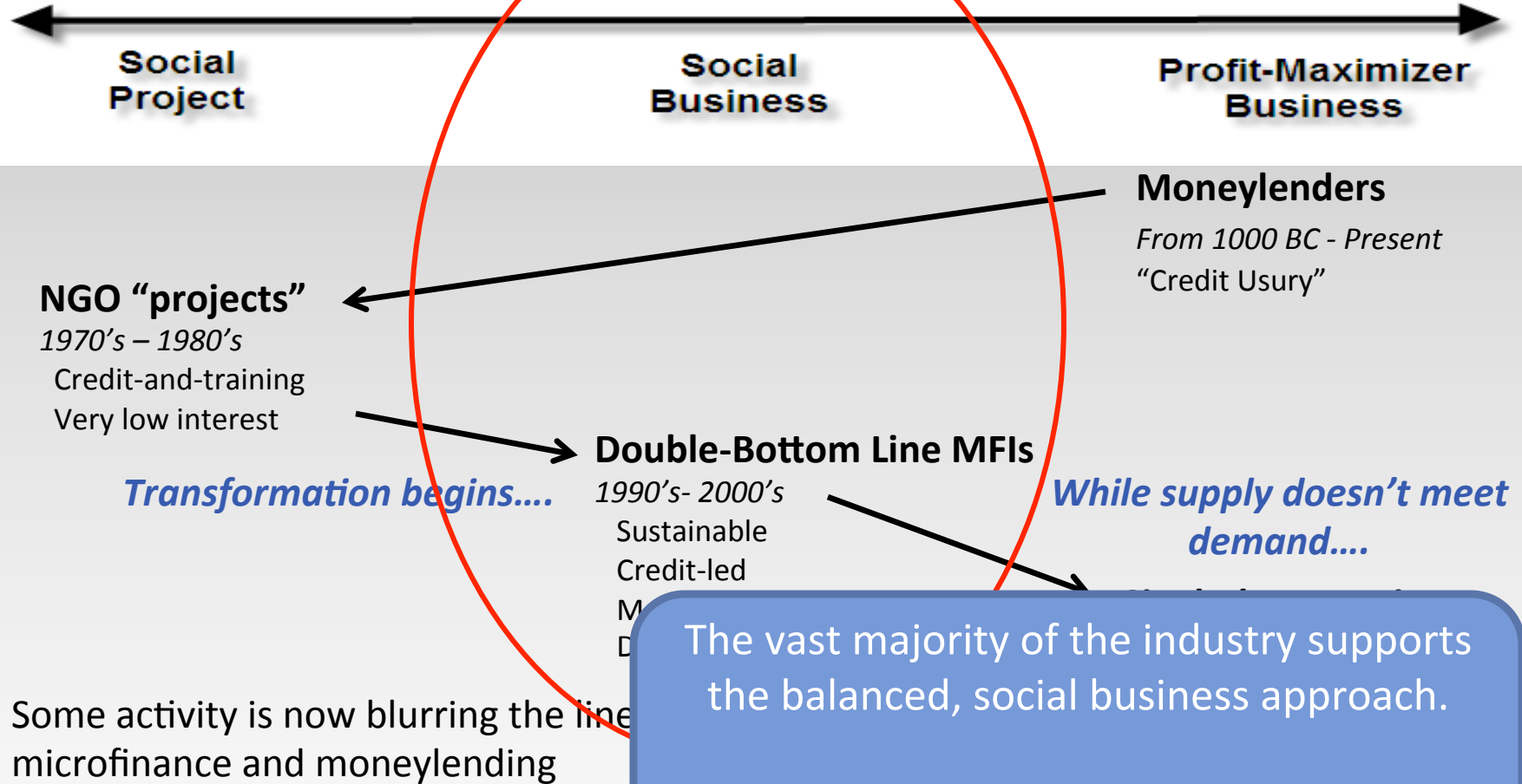
# Financial Services for the Poor

## 3000 Years on One Slide



# Financial Services for the Poor

## 3000 Years on One Slide





# Innovations and Mission Drift

1. 1462: Franciscans in Italy set up interest-free loans to the poor, using collateral goods
2. They were called “**Funds of Mercy**”
3. This innovation to assist the poor spread throughout the world – as **pawnshops**
4. 500 years later, we start microfinance as a way to get loans to the poor.
5. **Our responsibility is to protect microfinance from following this same path.**

# The Challenge of Public-traded for-profits

“A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end.”

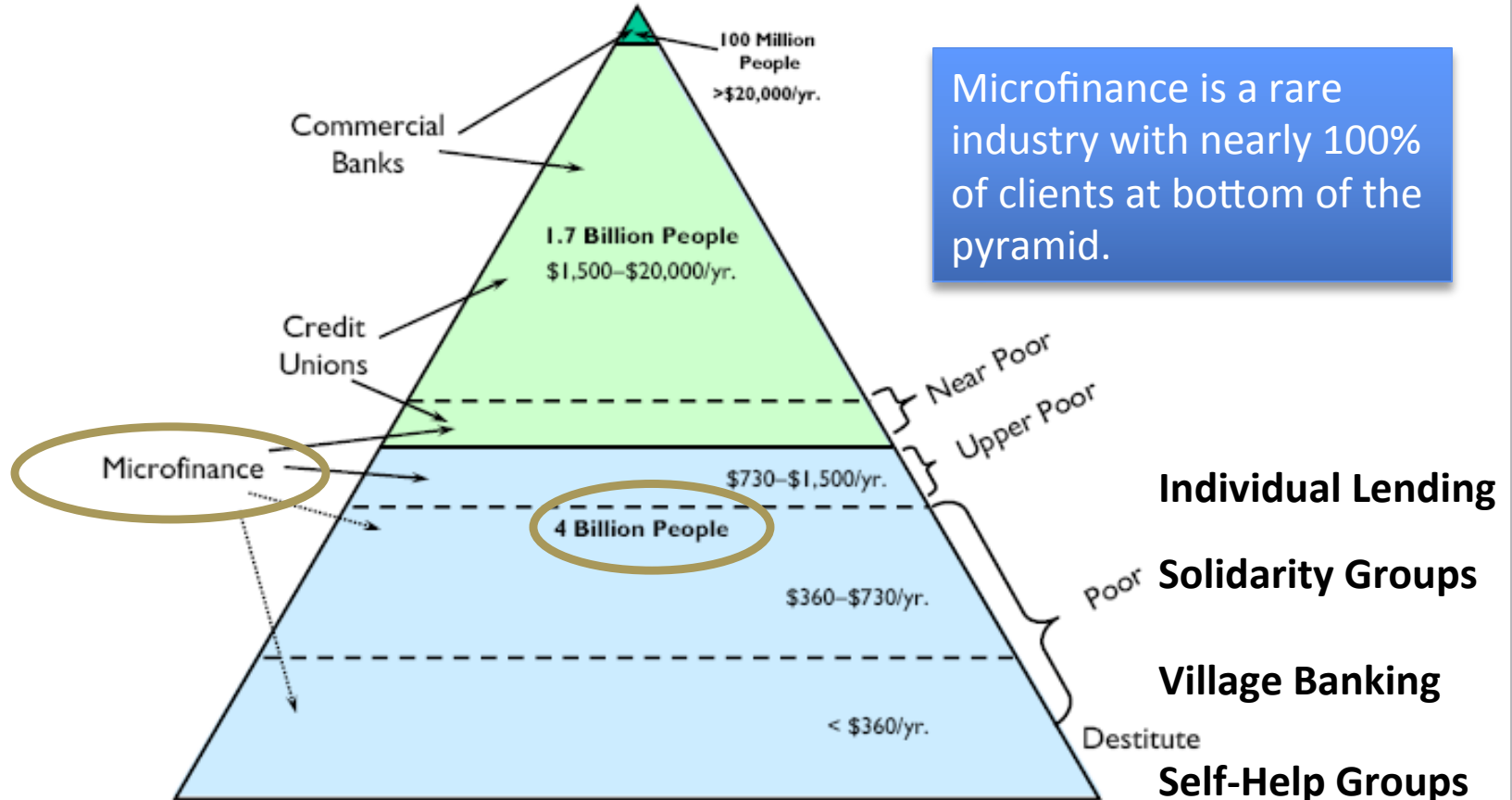
US Supreme Court

“The social responsibility of business [is] to increase its profits”

*Milton Freidman*

# The Income Distribution Pyramid

## Microfinance Can Reach the Lower Income Levels



\*Sources: VISA International, World Bank, C.K. Pralahad

# First reference to the “Bottom of the Pyramid”

“These unhappy times call for the building of plans:

- that rest upon the forgotten... but indispensable units of economic power...
- that build from the bottom up and not from the top down,
- that put their faith once more in the forgotten man at the **bottom of the economic pyramid.**”

President Franklin D. Roosevelt, 1932

2011 – We are once again in the midst of unhappy times, again brought on by irresponsible financial practice. It is time to build new plans.

# Responsible Behavior is an Obligation

1. Our clients are the very poor
2. We hold power, with power comes responsibility
  - Micro-credit is not an exchange negotiated between equal parties
3. The temptation of large profits can lead some to irresponsible practice
4. Irresponsible practice leads to client abuse

# Responsible Behavior is an Obligation

## THEREFORE

1. The obligation of stakeholders inside microfinance is to self-regulate the industry and promote responsible practice
2. We need regulators to assist us with formal regulation that helps the balance the power
3. Doing so protects both the poor and the industry

# Gandhi's Seven Deadly Social Sins

1. Politics without principle
2. Wealth without work
3. Commerce without morality
4. Pleasure without conscience
5. Education without character
6. Science without humanity
7. Worship without sacrifice

These principles are the foundation of  
**“Responsibility”**

# Challenge of Responsible Business

1. We define impact primarily in increasing the household income of the poor
2. We advocate using for-profit businesses to provide financial services
3. Every dollar of profit comes out of the household income of the poor



# Prices and Profits

## Compartamos (Mexico)

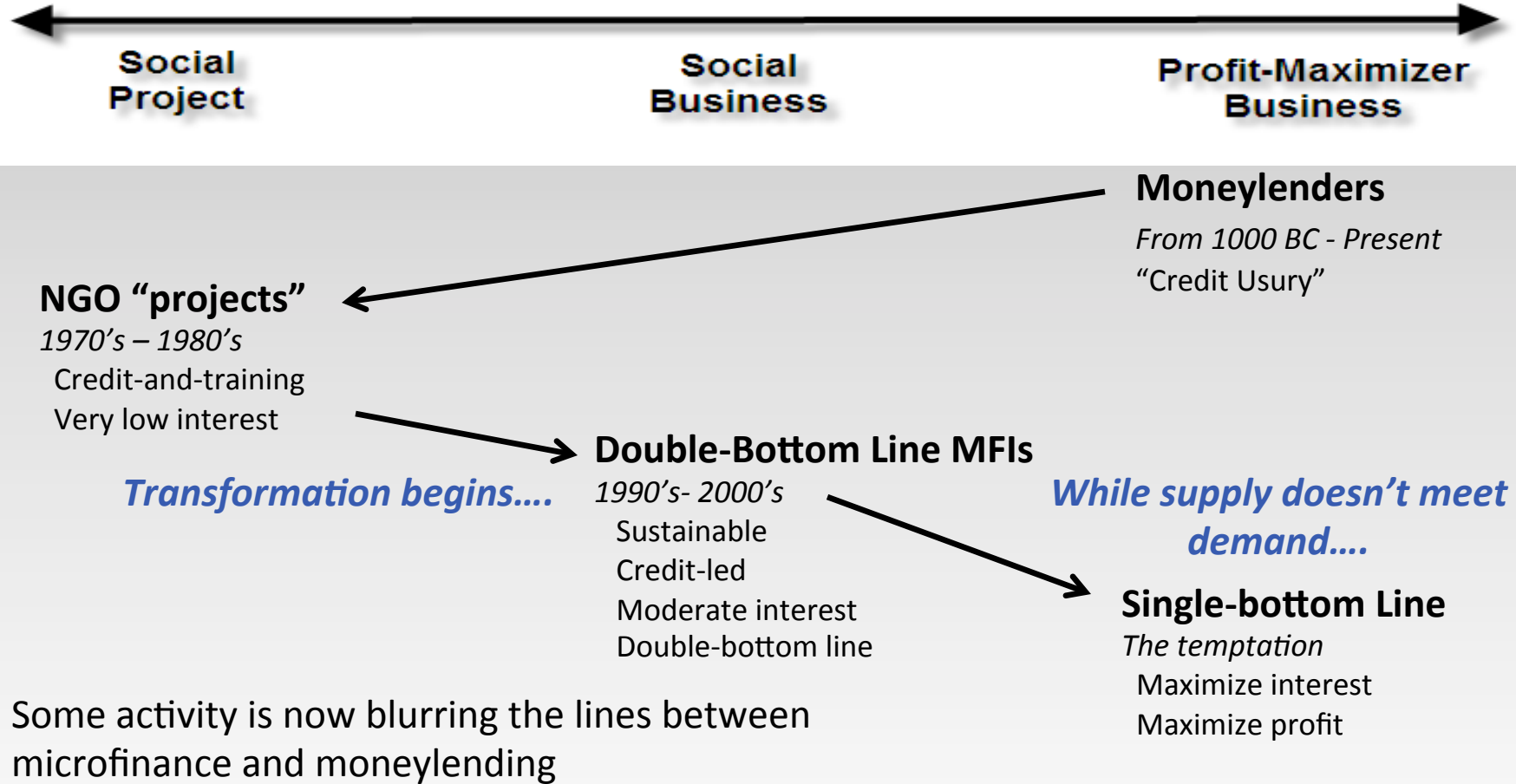
The Price	APR
w/o Collateral Deposit	105%
With Collateral Deposit	126%

The IPO in 2007 resulted in a 300-to-1 return on investment made in 2000.

Year	ROE
2000	62%
2001	40%
2002	54%
2003	53%
2004	49%
2005	55%
2006	57%
2007	54%
2008	55%
2009	43%

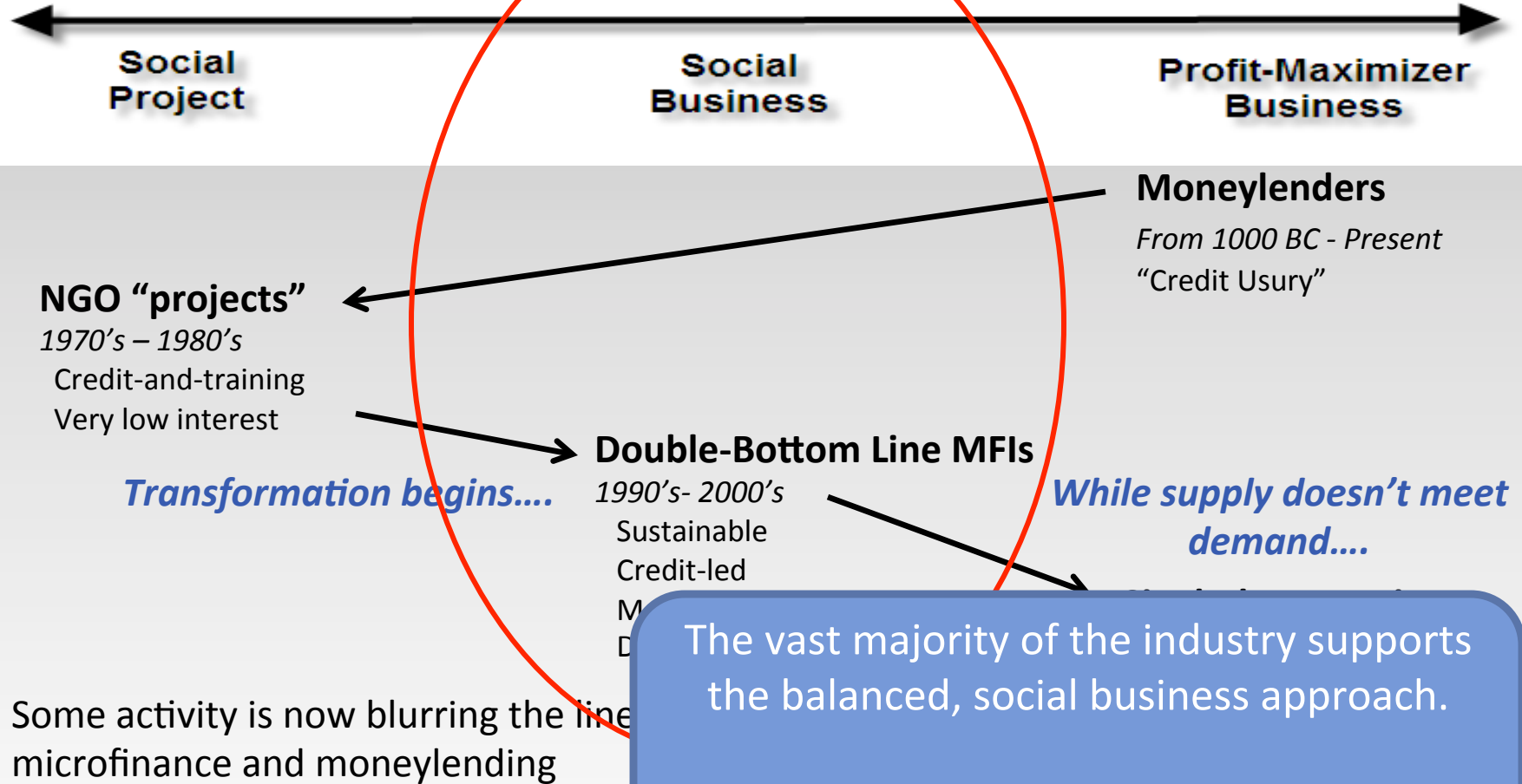
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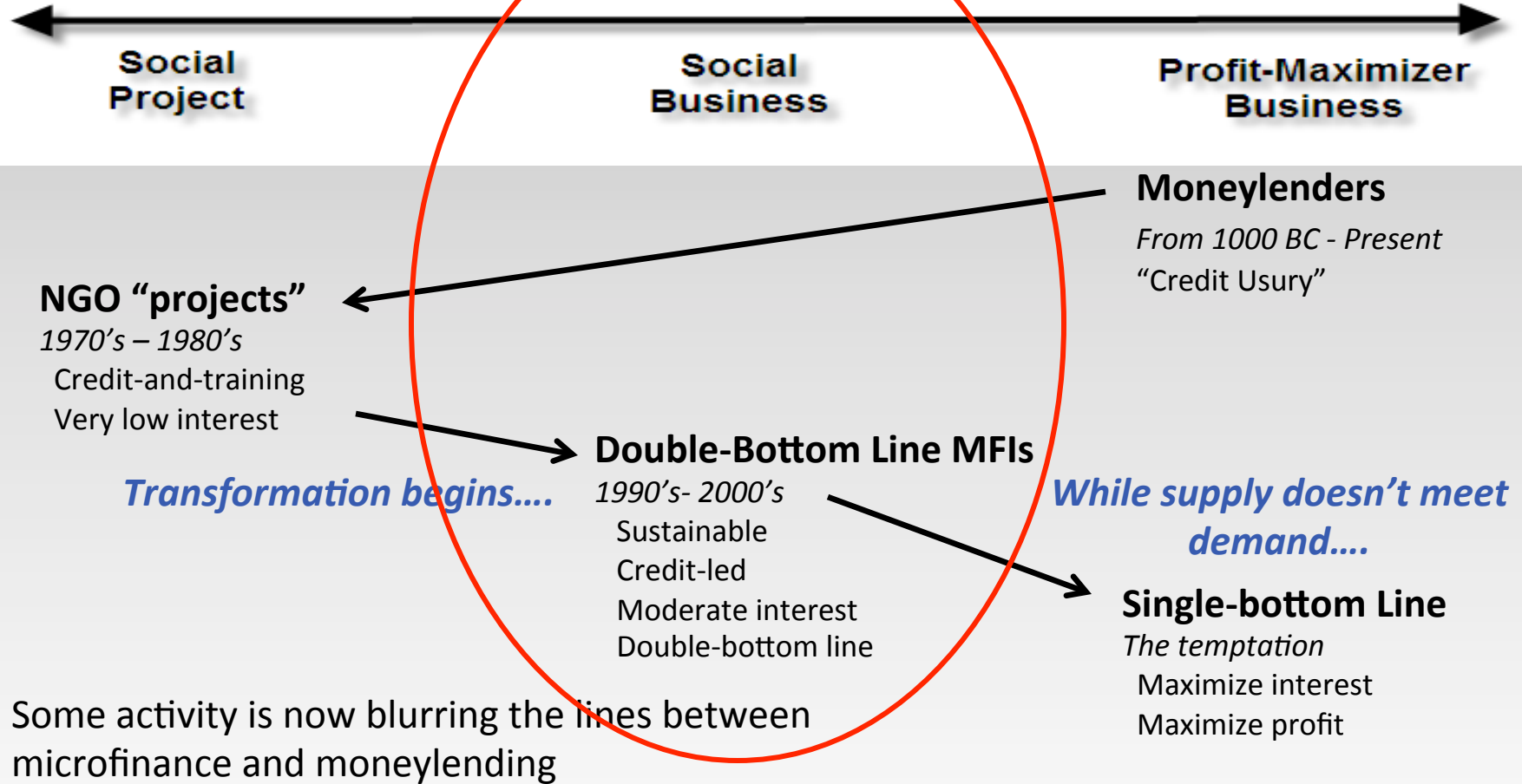
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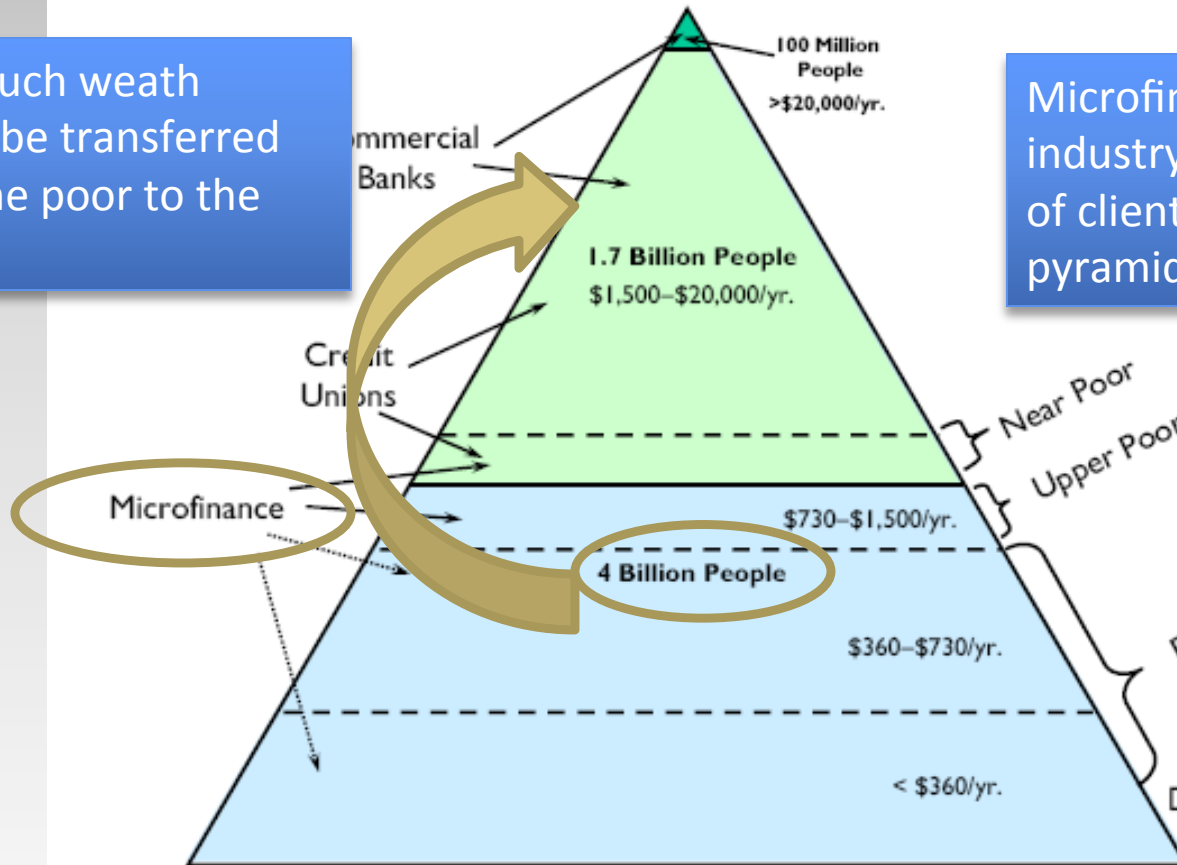


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Individual Lending

Solidarity Groups

Village Banking

Self-Help Groups

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# Promoting Transparent Pricing in the Microfinance Industry

MicroFinance Transparency is an NGO registered in the USA

