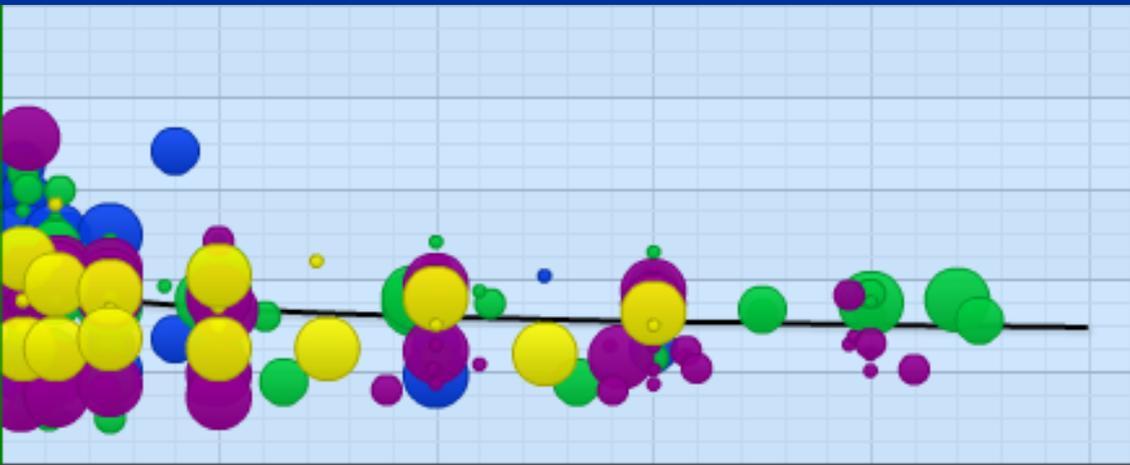


After Transparency, How to Define Responsible Pricing?

Chuck Waterfield
CEO

MicroFinance Transparency
March 2014



Sign in a pub in Frankfurt Germany





FREE

WI-FI

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GREAT SERVICE

ALL DAY

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Questions we have been ignoring for 30 years

1. What price do we really charge?
2. What price do we tell the client?
3. What is a transparent price?
4. What is a responsible price?

We really need to understand (1), (2), and (3) before we can make intelligent decisions on (4)

Do we really have non-transparent pricing in microfinance?

Here's an example of what a client faces in shopping for a loan

Which loan would you pick?

	Zero Interest Loan	Interest and Fees	And Savings	Interest Only
Loan amount:	\$1,000	\$1,000	\$1,000	\$1,000
Loan term:	10 weeks	10 weeks	10 weeks	10 weeks

Which loan would you pick?

	Zero Interest Loan	Interest and Fees	And Savings	Interest Only
Loan amount:	\$1,000	\$1,000	\$1,000	\$1,000
Loan term:	10 weeks	10 weeks	10 weeks	10 weeks
Interest Rate:	0%			
Upfront fee:	5%			
Savings:	0%			

Which loan would you pick?

	Zero Interest Loan	Interest and Fees	And Savings	Interest Only
Loan amount:	\$1,000	\$1,000	\$1,000	\$1,000
Loan term:	10 weeks	10 weeks	10 weeks	10 weeks
Interest Rate:	0%	15% ("flat")		
Upfront fee:	5%	2%		
Savings:	0%	0%		

Which loan would you pick?

	Zero Interest Loan	Interest and Fees	And Savings	Interest Only
Loan amount:	\$1,000	\$1,000	\$1,000	\$1,000
Loan term:	10 weeks	10 weeks	10 weeks	10 weeks
Interest Rate:	0%	15% ("flat")	12% ("flat")	
Upfront fee:	5%	2%	1%	
Savings:	0%	0%	20%	

Which loan would you pick?

	Zero Interest Loan	Interest and Fees	And Savings	Interest Only
Loan amount:	\$1,000	\$1,000	\$1,000	\$1,000
Loan term:			10 weeks	10 weeks
Interest rate:			12% ("flat")	36% decl
Upfront fees:			1%	0%
Savings:			20%	0%
TCC	\$50	\$50	\$33	\$38
APR	48%	48%	48%	36%
Transparency Index				

Nominal Annual Interest Rate

Full APR

Full Transparency = 100

Which loan would you pick?

	Zero Interest Loan	Interest and Fees	And Savings	Interest Only
Loan amount:	\$1,000	\$1,000	\$1,000	\$1,000
Loan term:	10 weeks	10 weeks	10 weeks	10 weeks
Interest Rate:	0%	15% ("flat")	12% ("flat")	36% decl
Upfront fee:	5%	2%	1%	0%
Savings:	0%	0%	20%	0%
TCC	\$50	\$50	\$33	\$38
APR	48%	48%	48%	36%
Transparency Index	0	32	25	100

What is the APR?

(Annual Percentage Rate)

The APR indicates the cost for you to borrow \$1.00 for one year. *It is a unit rental cost.*

An APR of 30% means it would cost you 30 cents to borrow \$1.00 and keep the entire \$1.00 for one full year.

The APR is an essential figure for you to compare the true cost of different loans.

What Prices Do We Charge?

Cardinal Rule in analyzing micro-loans:

Never use averages

Pause from PowerPoint....

Pricing Graphs on MFTransparency website

APR & EIR in Excel Workbook

**Pricing for Sustainability must
address the reality of the COST
curve**

Reality of a Delivery Cost curve

Efficiency	1	2	3
Operating Cost per Loan			\$50
Loan Size			\$500
Operating Cost Ratio			10%

Reality of a Delivery Cost curve

Efficiency	1	2	3
Operating Cost per Loan			\$50
Loan Size		\$250	\$500
Operating Cost Ratio			10%

Reality of a Delivery Cost curve

Efficiency	1	2	3
Operating Cost per Loan		\$50	\$50
Loan Size		\$250	\$500
Operating Cost Ratio		20%	10%

Reality of a Delivery Cost curve

Efficiency	1	2	3
Operating Cost per Loan		\$50	\$50
Loan Size	\$100	\$250	\$500
Operating Cost Ratio		20%	10%

Reality of a Delivery Cost curve

Efficiency	1	2	3
Operating Cost per Loan	\$30	\$50	\$50
Loan Size	\$100	\$250	\$500
Operating Cost Ratio	30%	20%	10%

Cost Components that Affect Pricing

Component	
Financial Costs	10%
Loan Loss	2%
Operating Costs	20%

Cost Components that Affect Pricing

Component	
Financial Costs	10%
Loan Loss	2%
Operating Costs	20%
Profit	3%
Total Price	35%

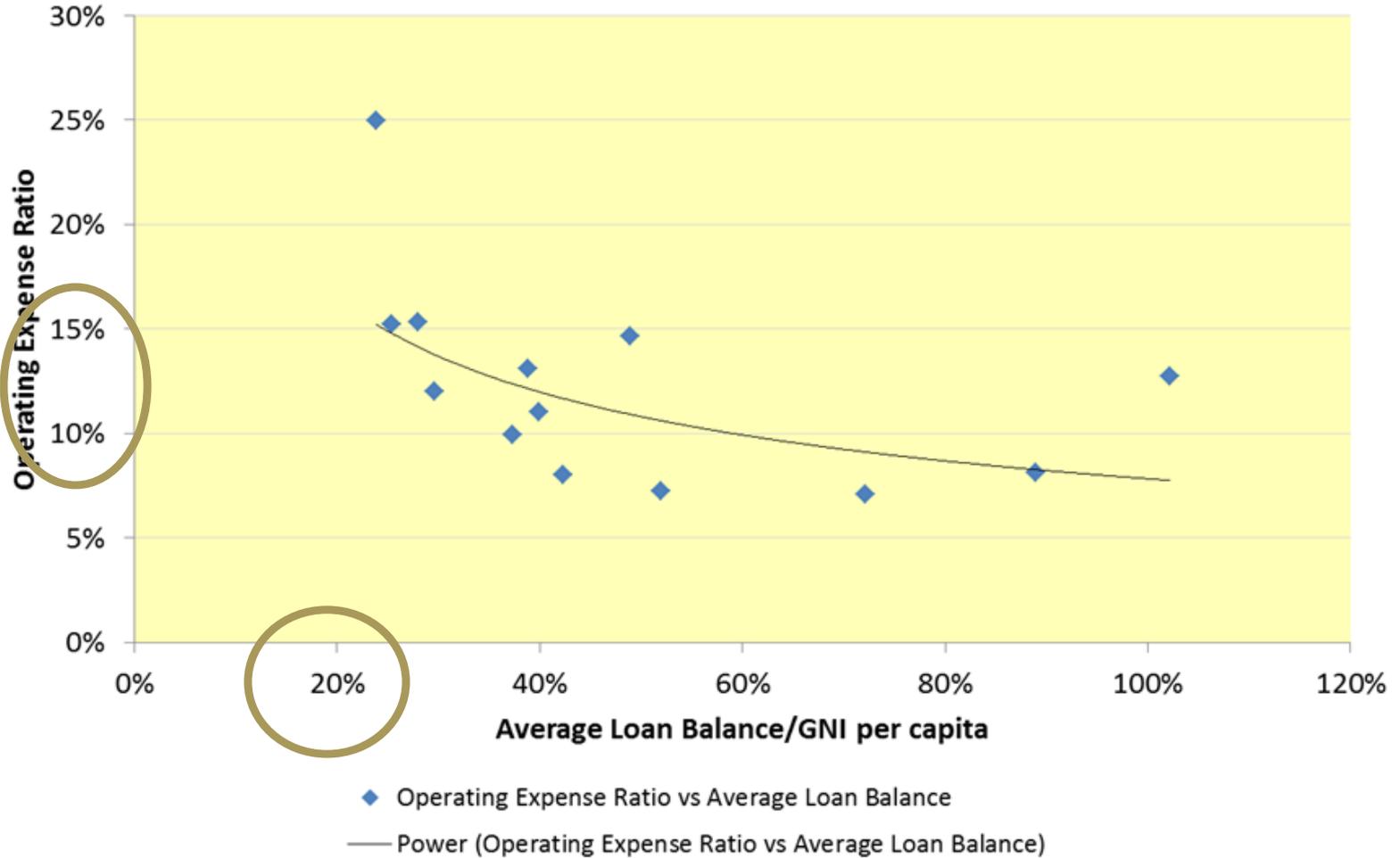
Cost Components that Affect Pricing

Component	\$1000	\$500	
Financial Costs	10%	10%	
Loan Loss	2%	2%	
Operating Costs	20%	30%	
Profit	3%	3%	
Total Price	35%	45%	

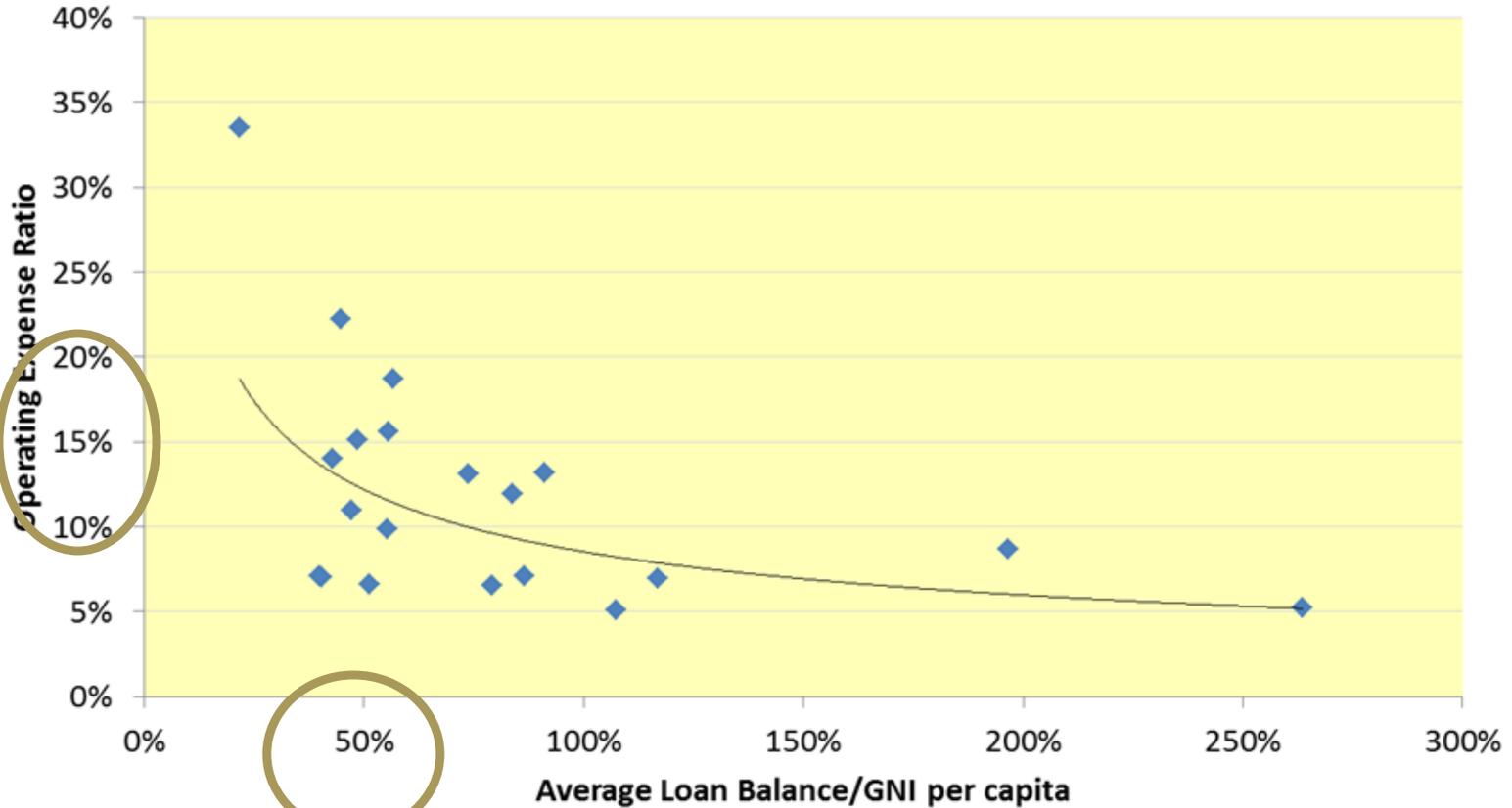
Cost Components that Affect Pricing

Component	\$1000	\$500	\$1000
Financial Costs	10%	10%	10%
Loan Loss	2%	2%	2%
Operating Costs	20%	30%	20%
Profit	3%	3%	13%
Total Price	35%	45%	45%

Operating Expense Ratio vs Average Loan Balance Bosnia and Herzegovina, 13 MFIs

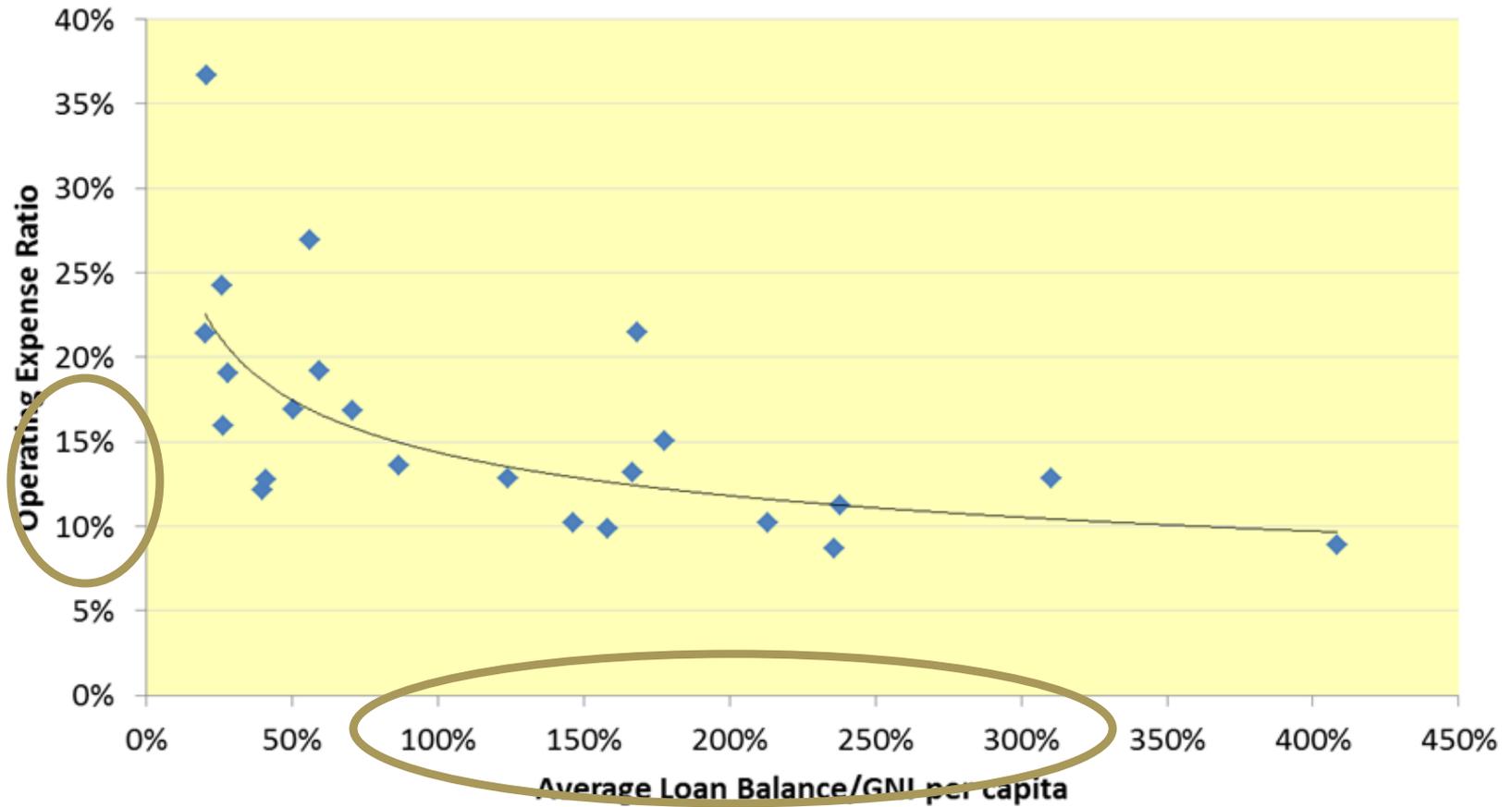


Operating Expense Ratio vs Average Loan Balance Bulgaria, 20 MFIs



- ◆ Operating Expense Ratio vs Average Loan Balance
- Power (Operating Expense Ratio vs Average Loan Balance)

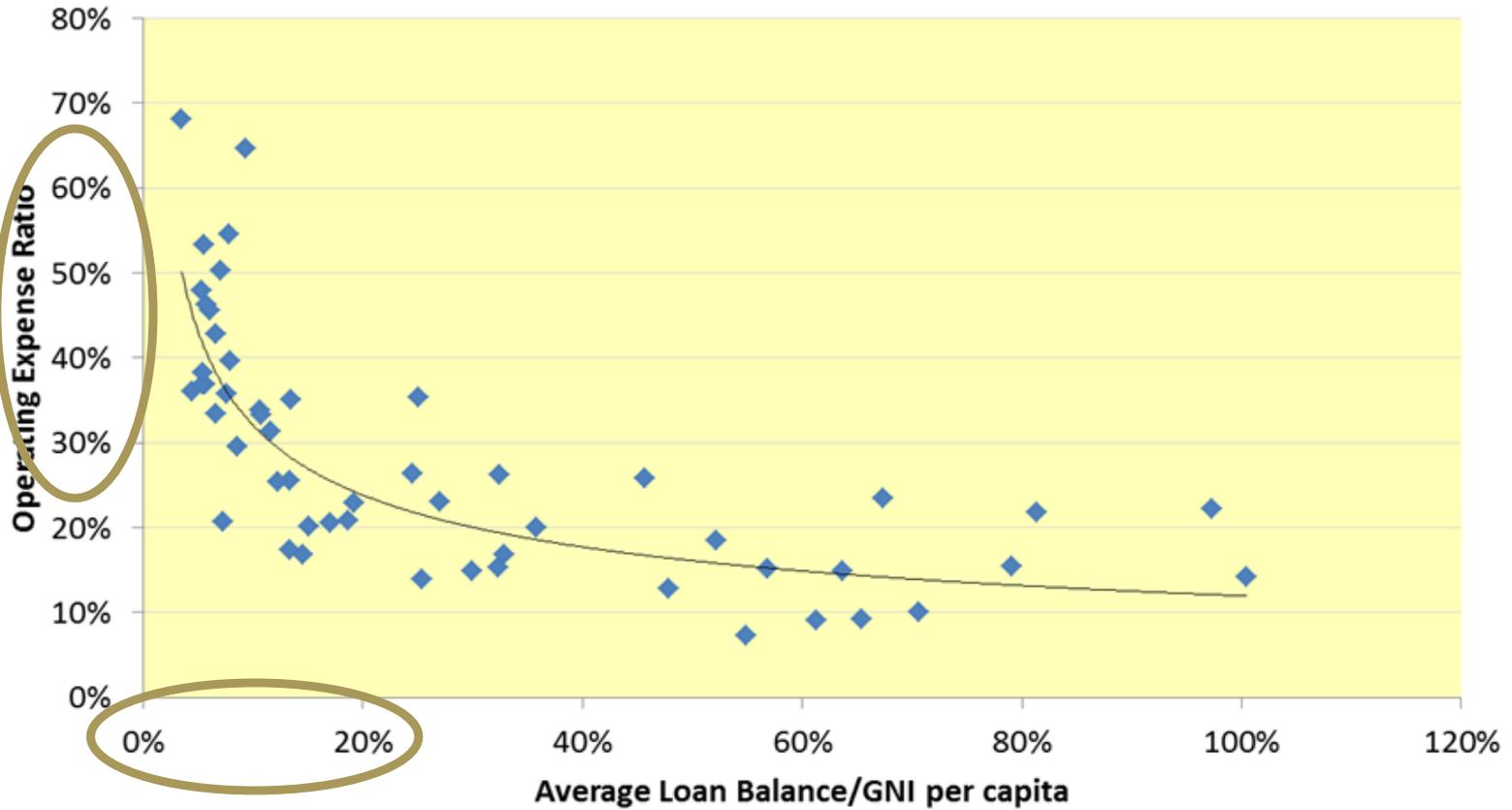
Operating Expense Ratio vs Average Loan Balance Bolivia, 23 MFIs



◆ Operating Expense Ratio vs Average Loan Balance

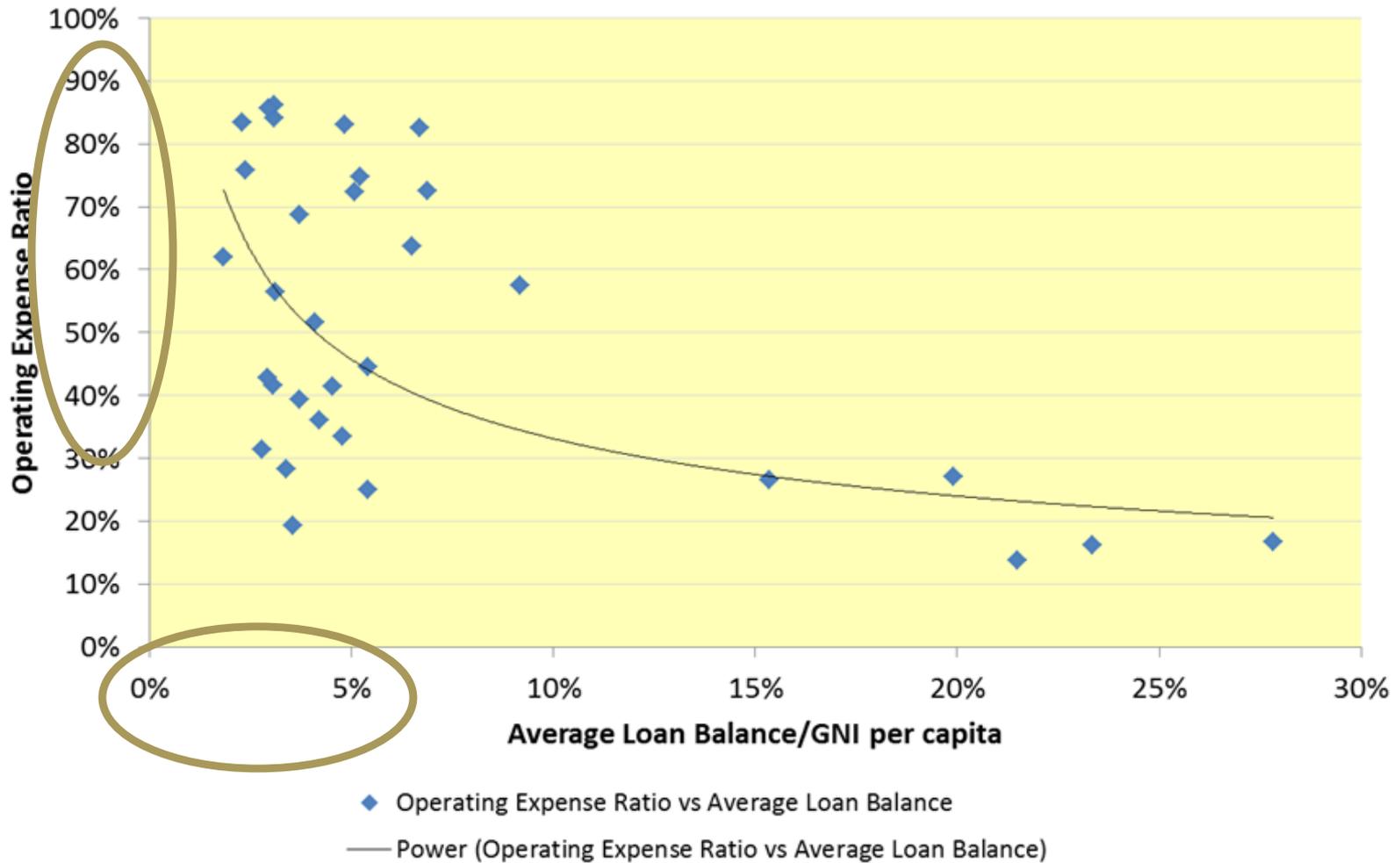
— Power (Operating Expense Ratio vs Average Loan Balance)

Operating Expense Ratio vs Average Loan Balance Philippines, 59 MFIs

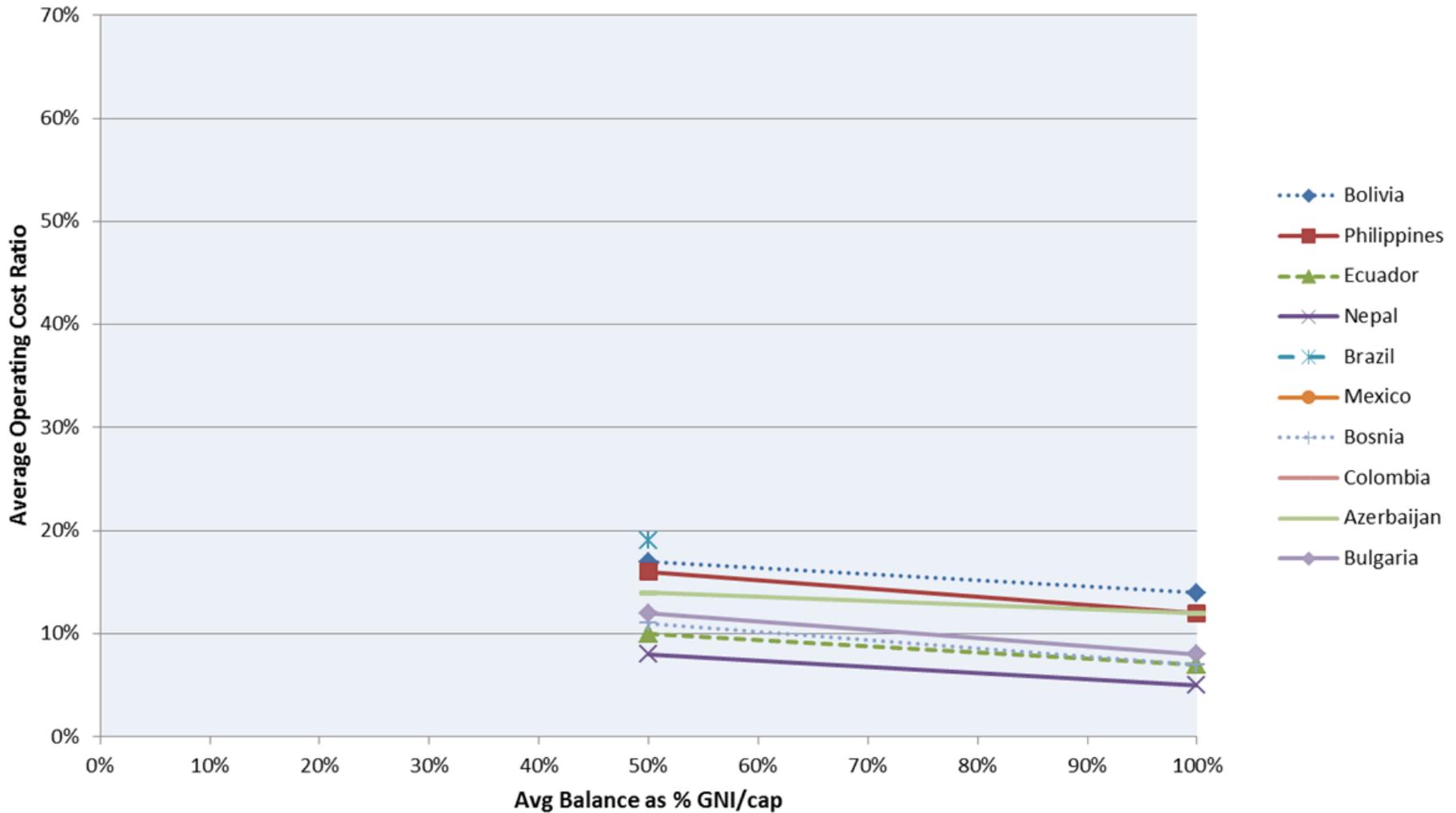


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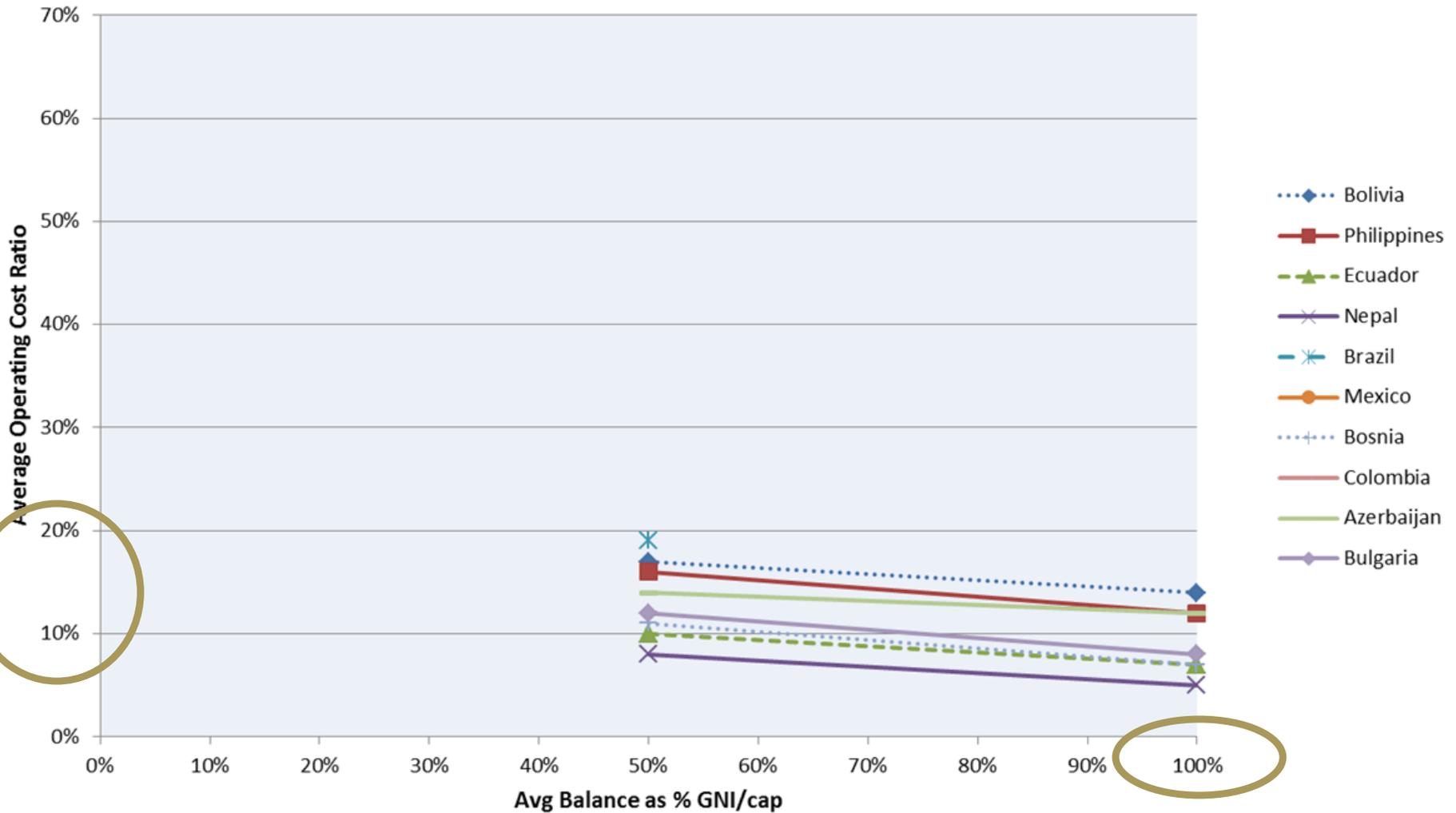
Operating Expense Ratio vs Average Loan Balance Mexico, 32 MFIs



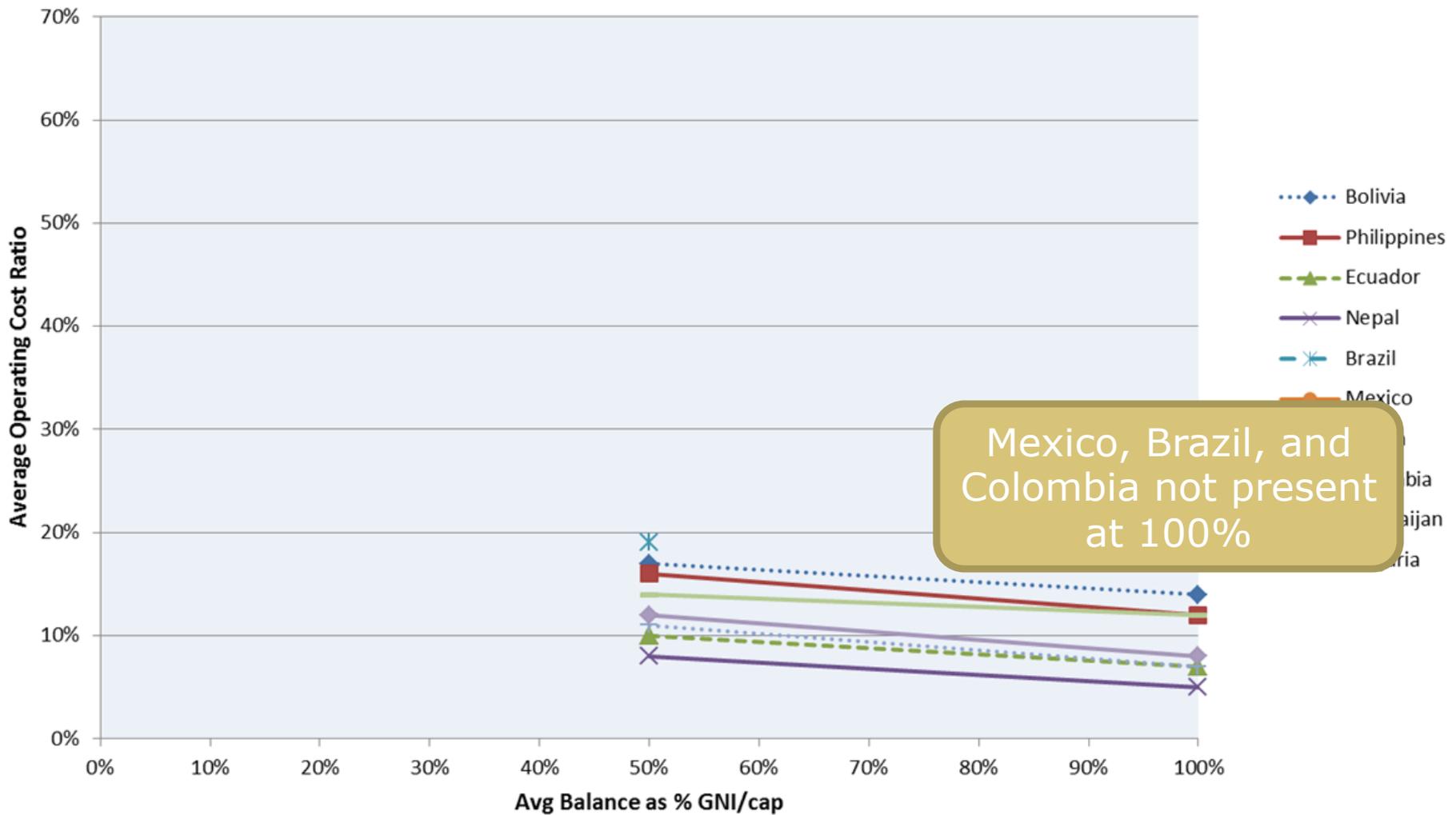
Average Op Cost Ratio by Loan Scale, selected countries



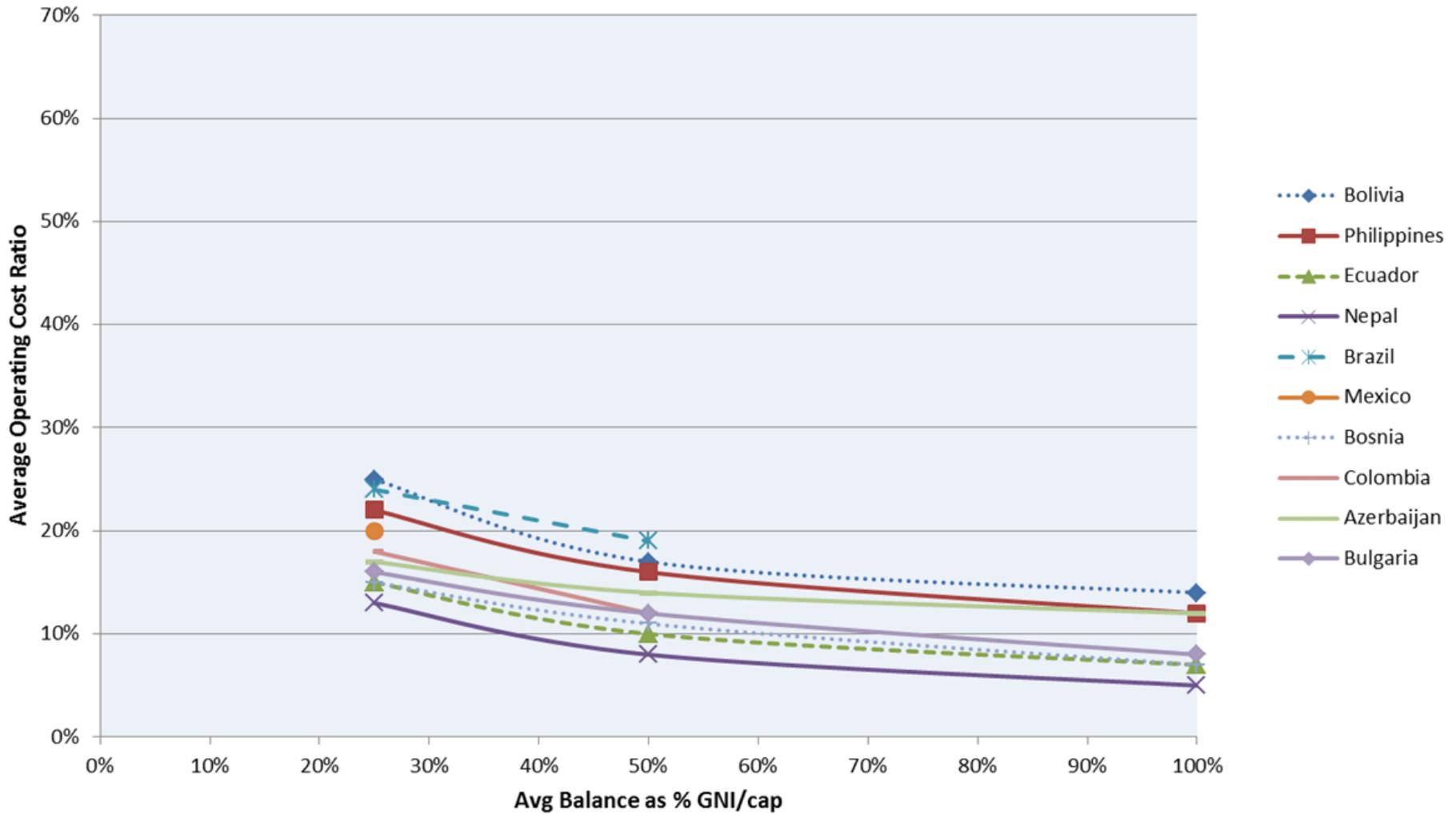
Average Op Cost Ratio by Loan Scale, selected countries



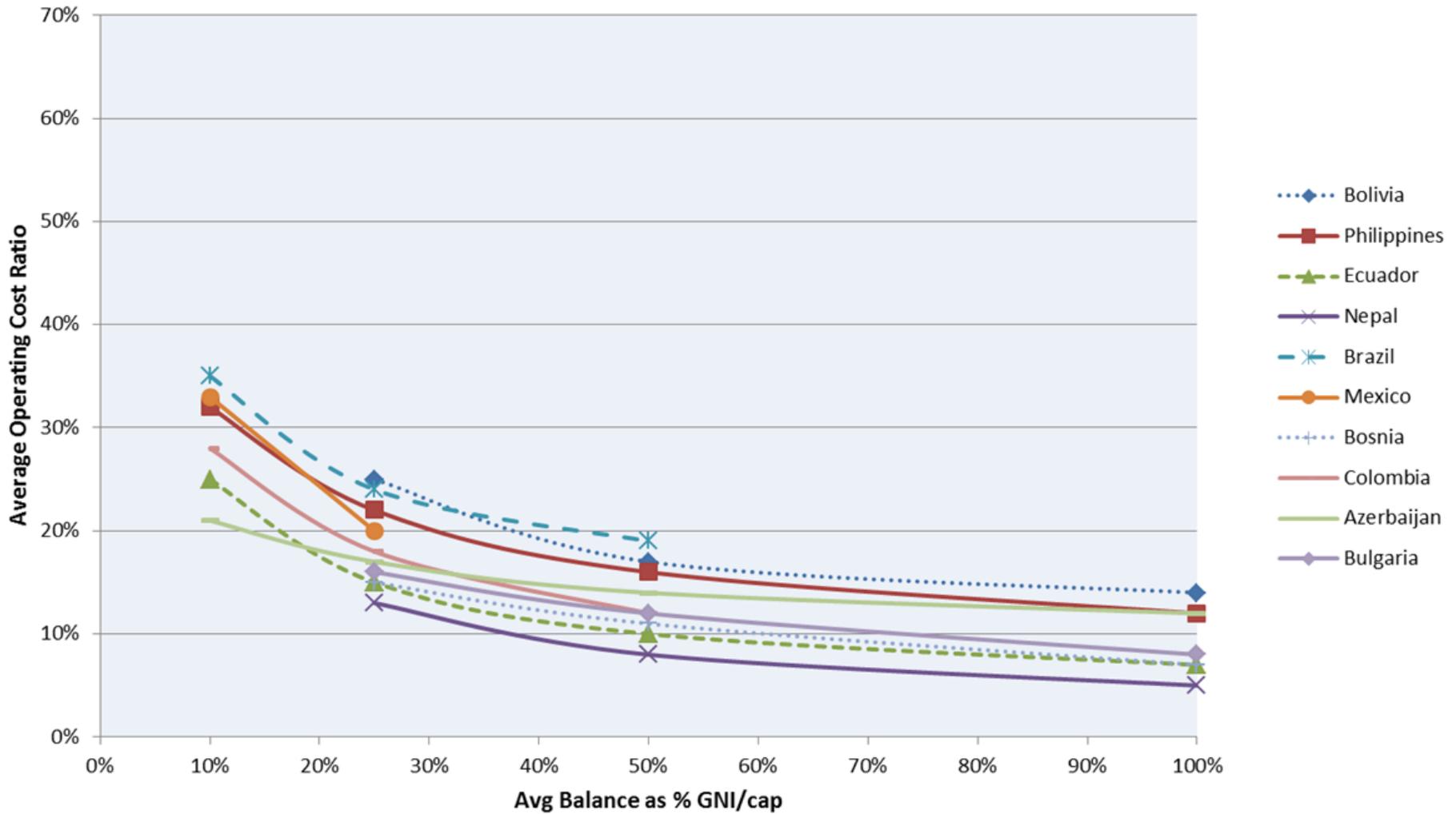
Average Op Cost Ratio by Loan Scale, selected countries



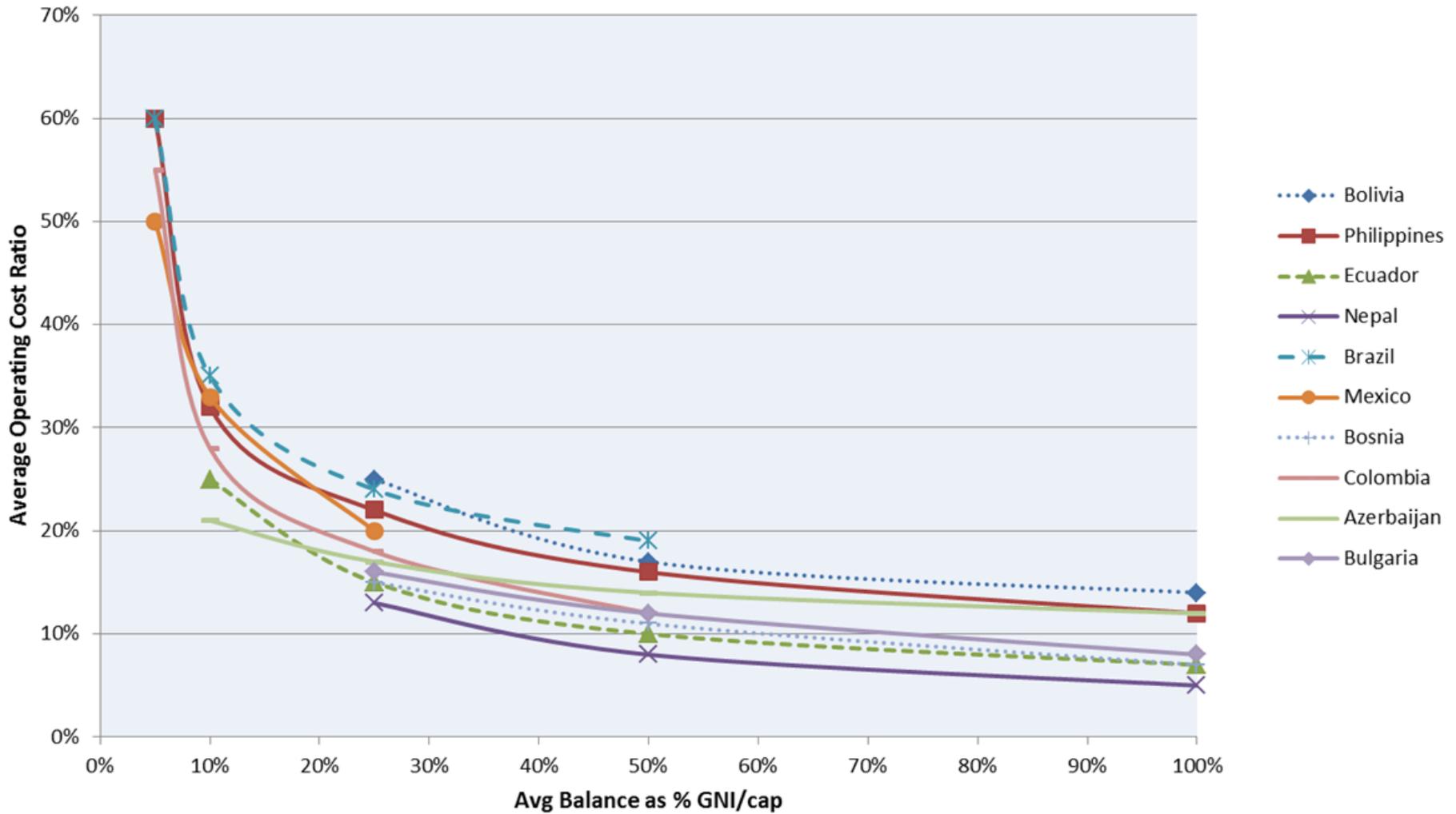
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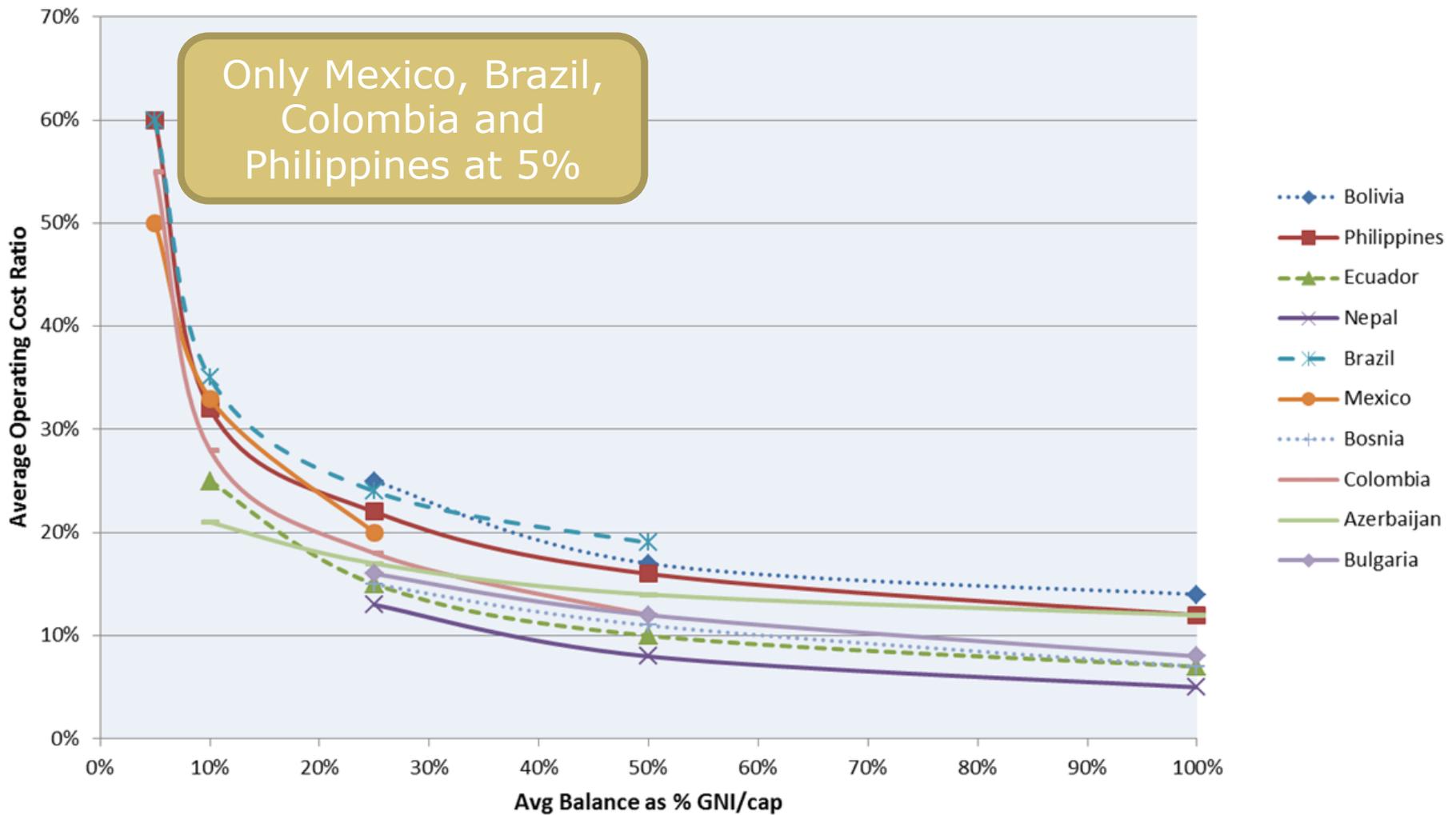
Average Op Cost Ratio by Loan Scale, selected countries



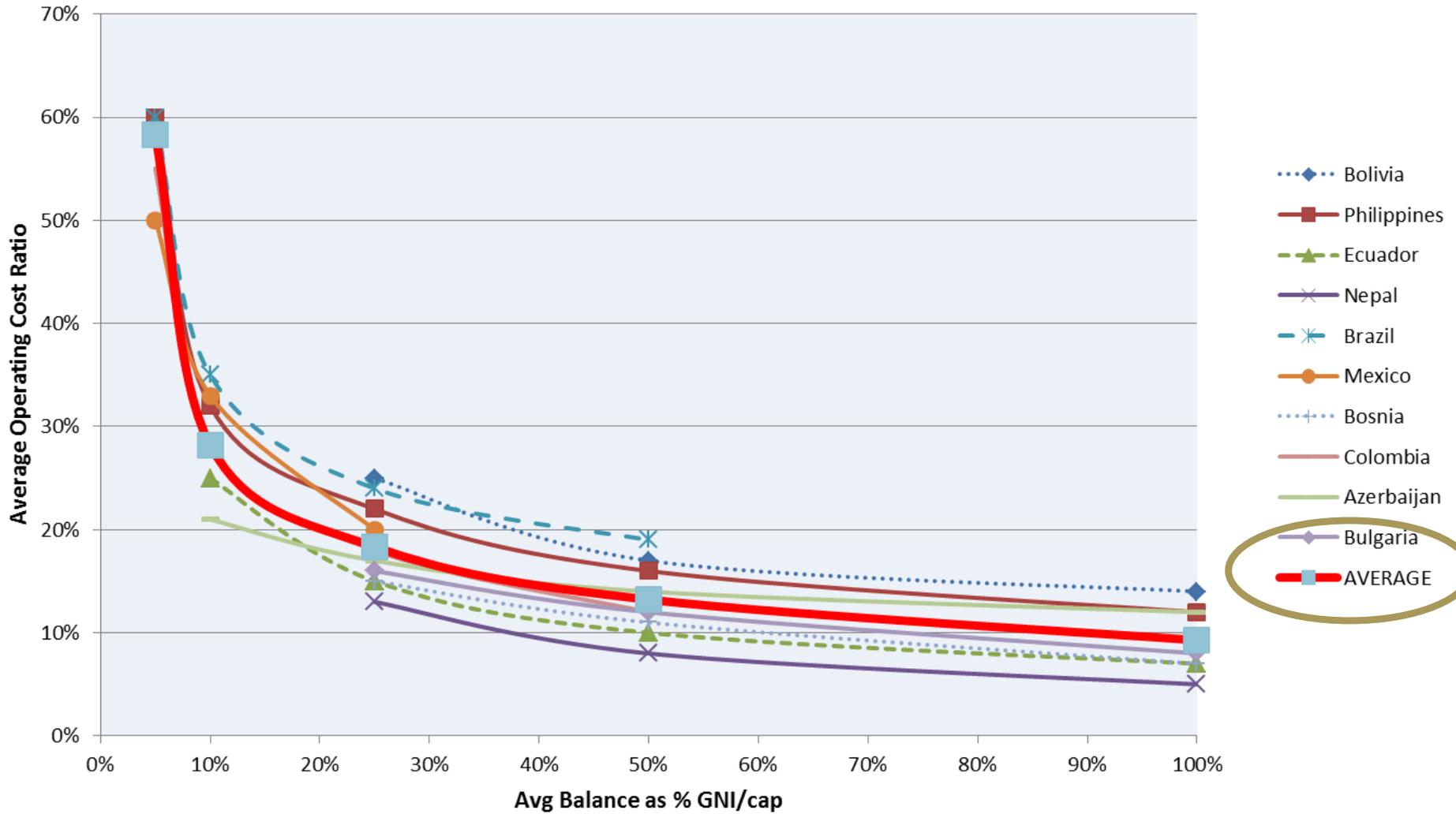
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Average Op Cost Ratio by Loan Scale, selected countries

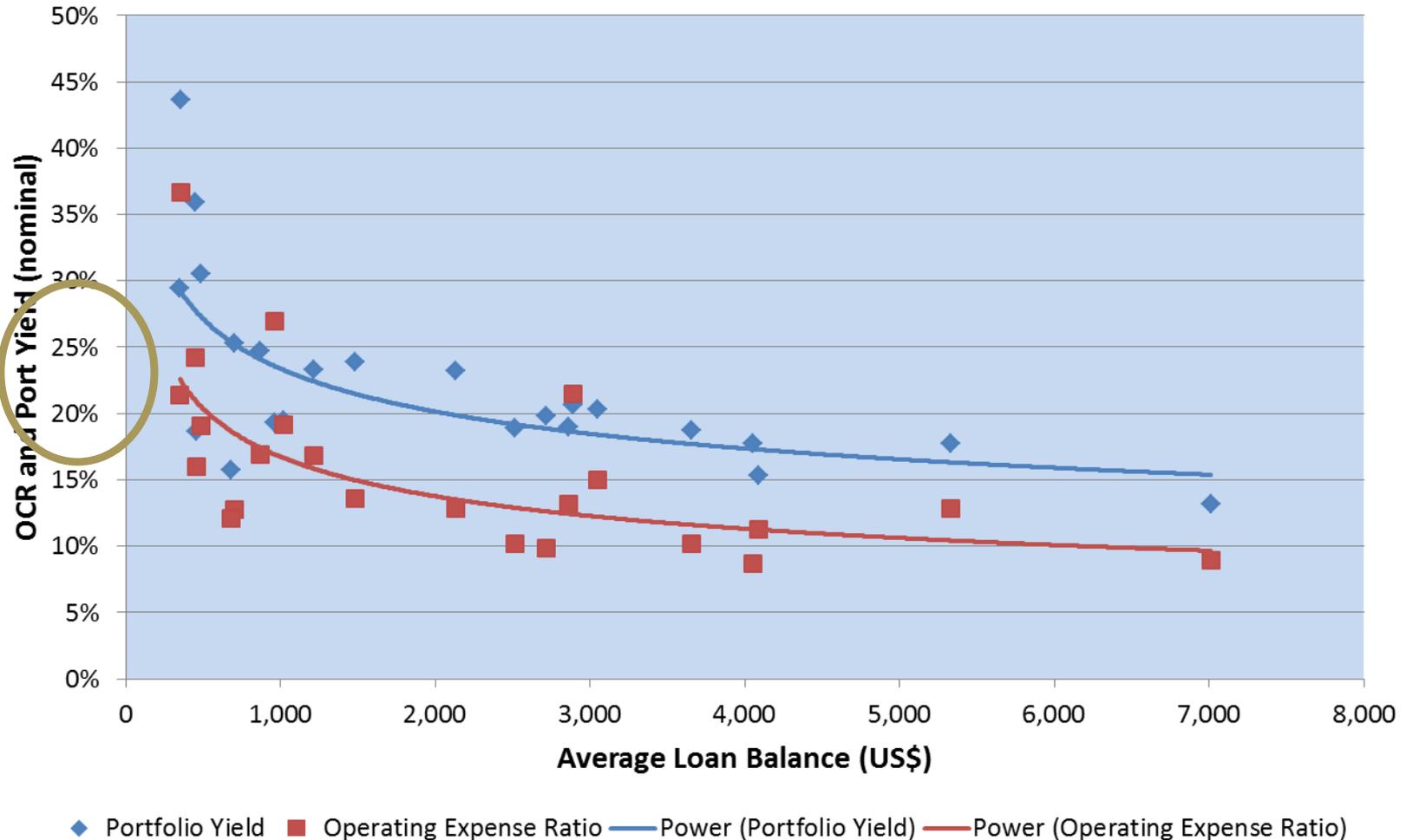


Average Op Cost Ratio by Loan Scale, selected countries



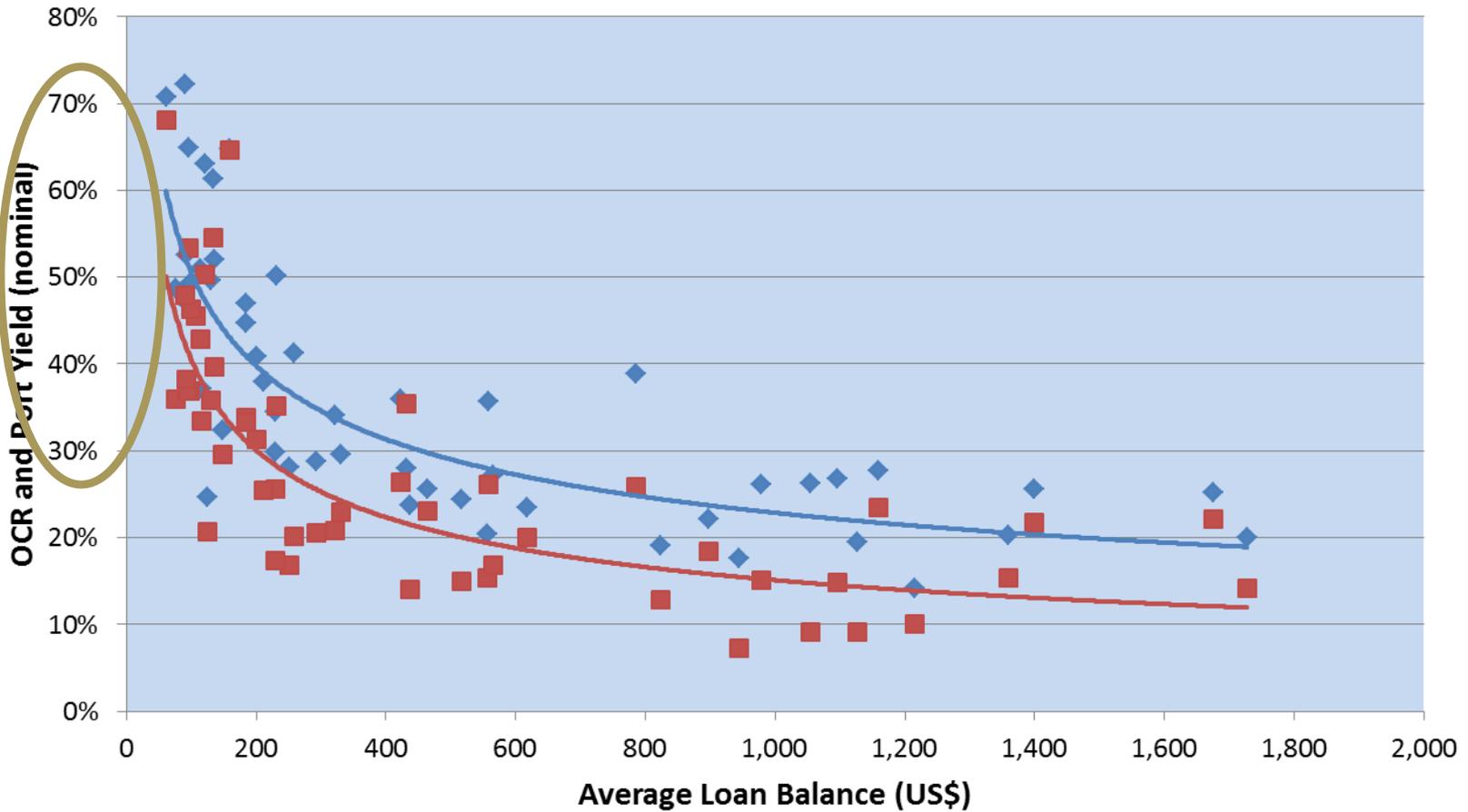
Price curve follows cost curve

Portfolio Yield & OER vs Average Loan Balance
Bolivia, 23 MFIs



Price curve follows cost curve

Portfolio Yield & OER vs Average Loan Balance
Philippines, 59 MFIs



◆ Portfolio Yield ■ Operating Expense Ratio — Power (Portfolio Yield) — Power (Operating Expense Ratio)

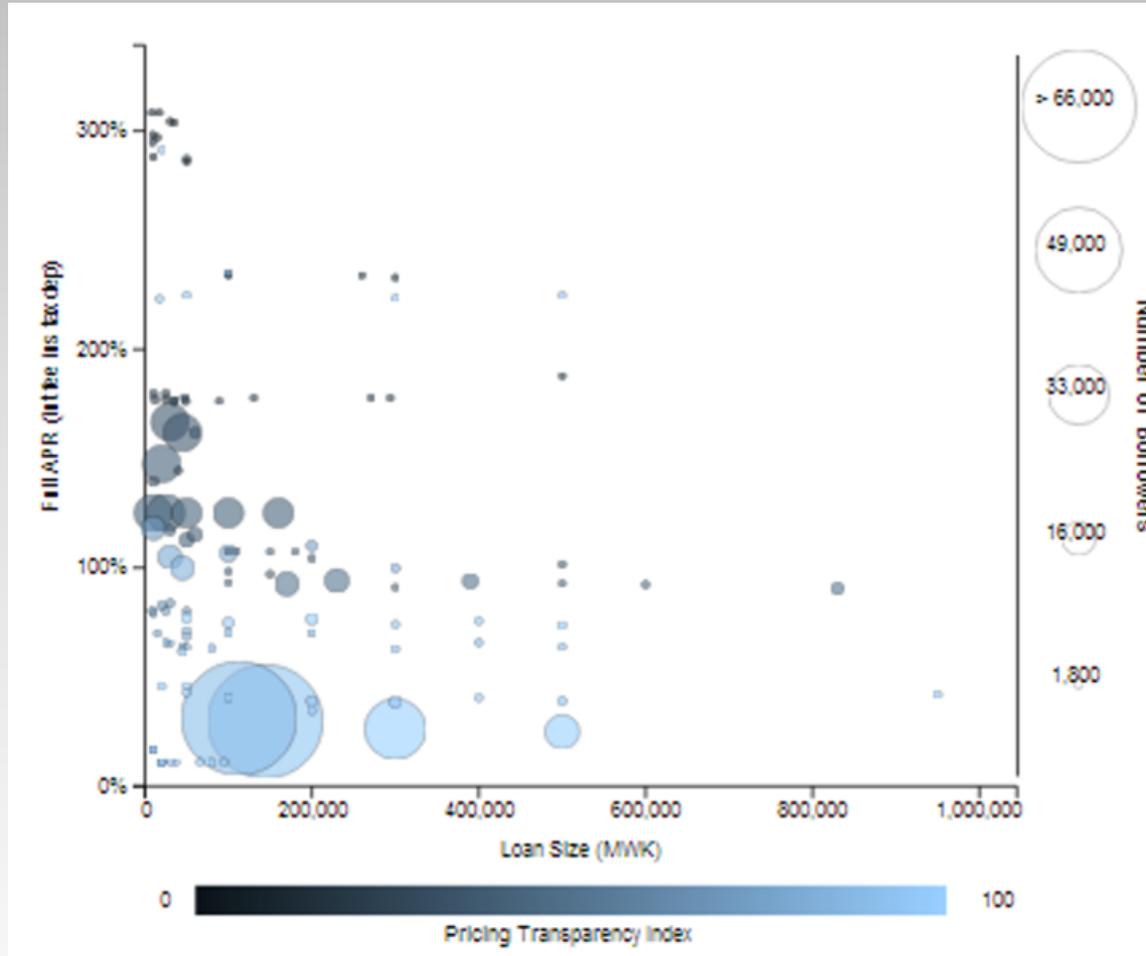
Pause from PowerPoint....

Price Analysis Tool on MFTransparency website

A new way to look at the data

1. Is an MFI close to the curve in its country for costs?
For portfolio yield?
2. If not, why not?
3. What spread has the MFI selected between its costs and the price it has chosen?

The MFT Website has a wealth of information



Opaque

Transparent

Responsible

- Transparent Prices
 - Now we know more about **what** prices we are charging
 - We know more about **why** we charge those prices
- Responsible Prices
 - Now we are moving forward to discussion of what prices we **should** charge (to support the ideals and values of the microfinance industry)
 - This is arguably the difficult part, the subjective part
 - **Should** we do it?
 - **How** would we do it?

Responsible Behavior is an Obligation

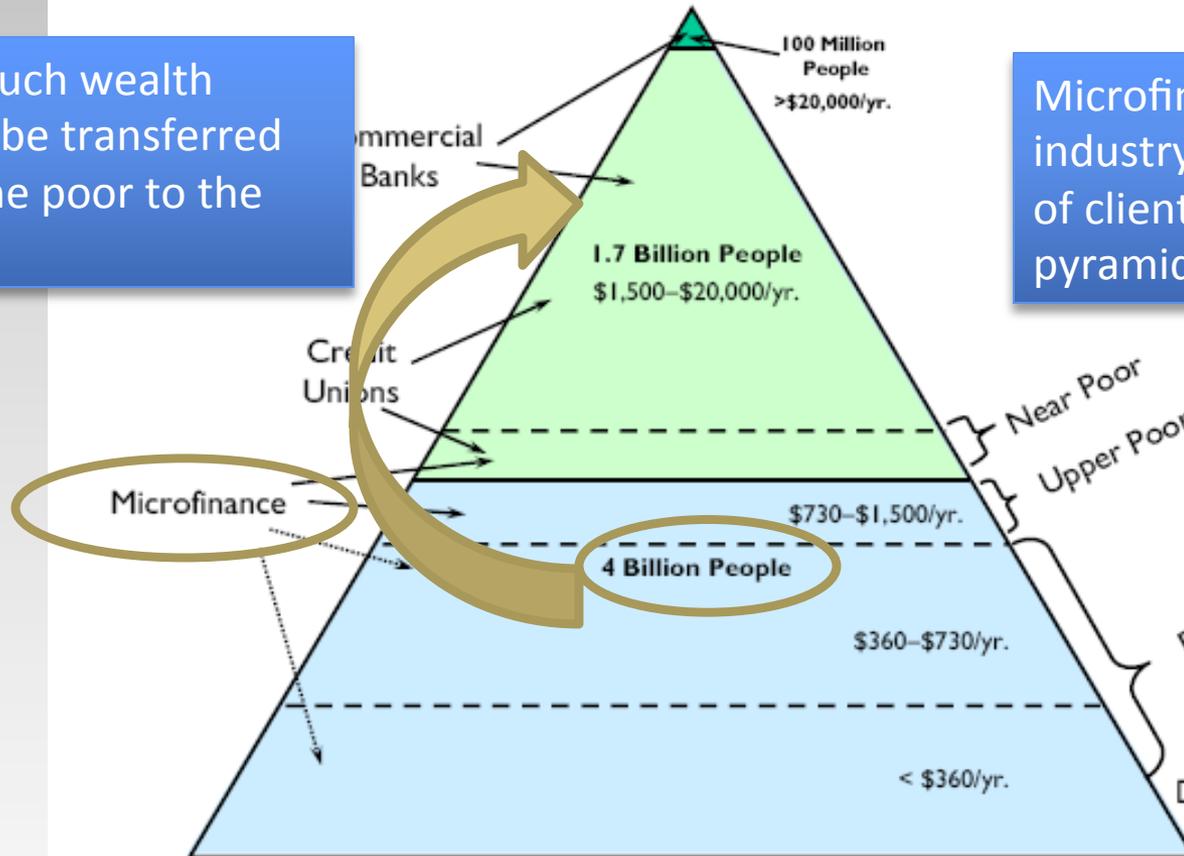
1. Microfinance take place in quite imperfect markets – without pricing transparency, there is no price competition
2. Our clients are the very poor
3. We hold power, with power comes responsibility
 - Micro-credit is not an exchange negotiated between equal parties
3. The temptation of large profits can lead some to irresponsible practice
4. Irresponsible practice leads to client abuse
5. This repeats the pattern of the past 3,000 years, but microfinance was created to be an alternative path.

The Income Distribution Pyramid

Microfinance Can Reach the Lower Income Levels

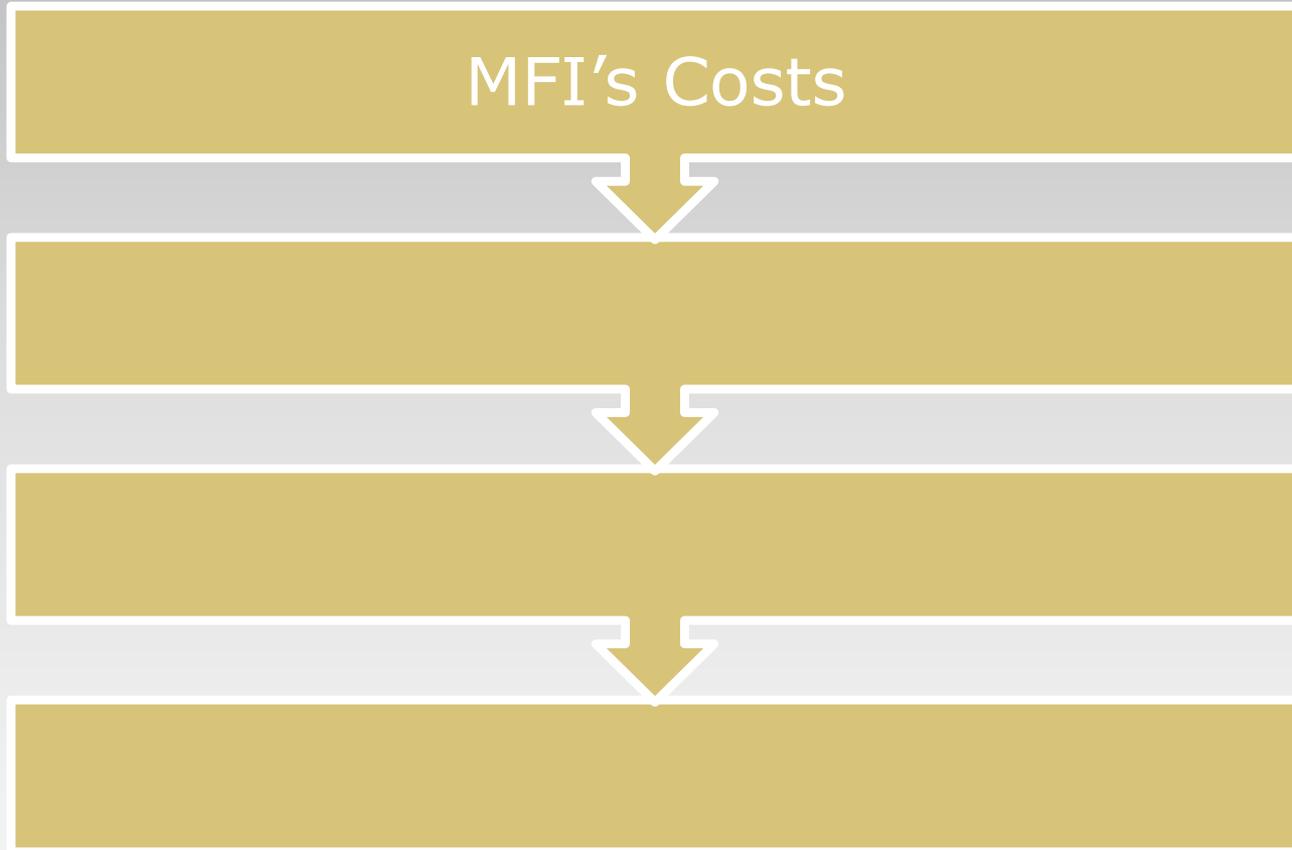
How much wealth should be transferred from the poor to the rich?

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

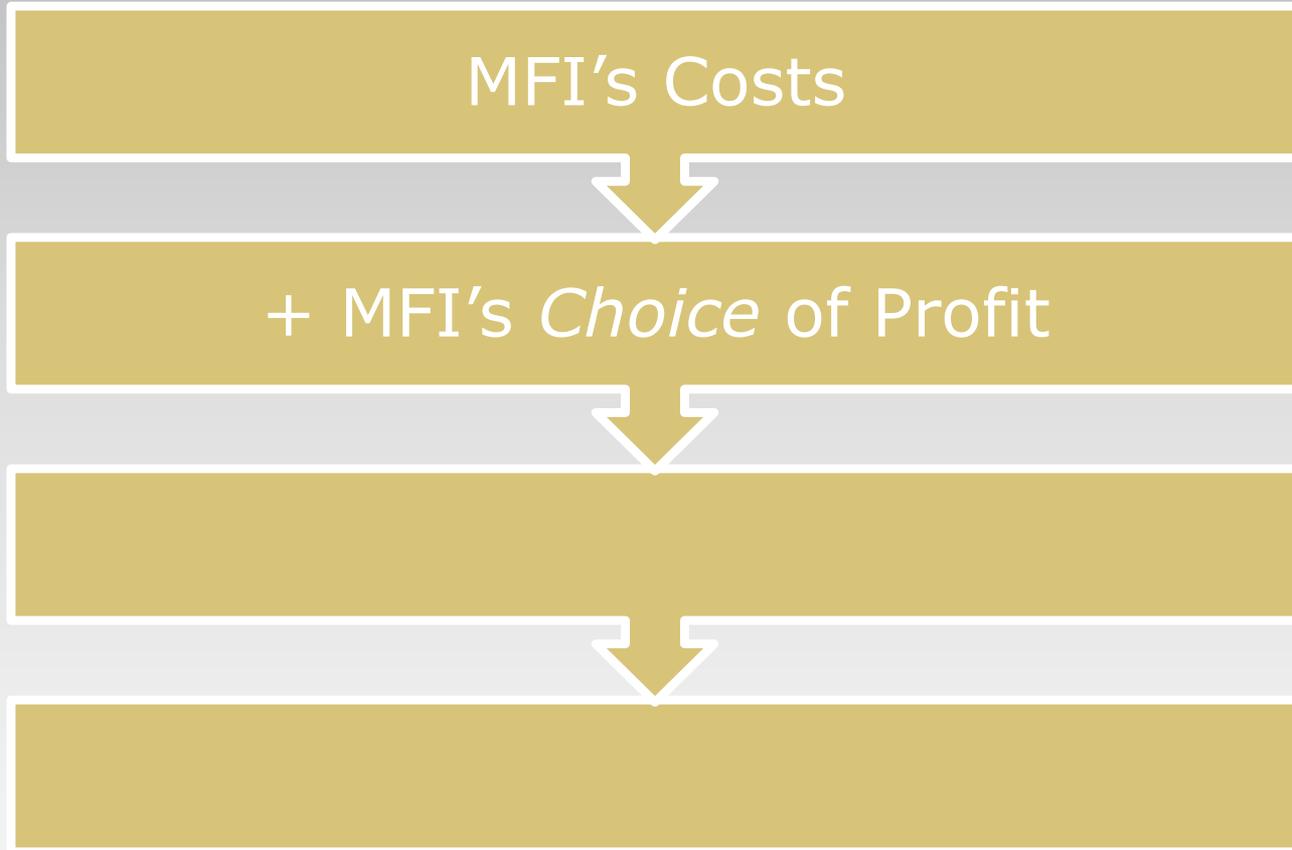


*Sources: VISA International, World Bank, C.K. Pralahad

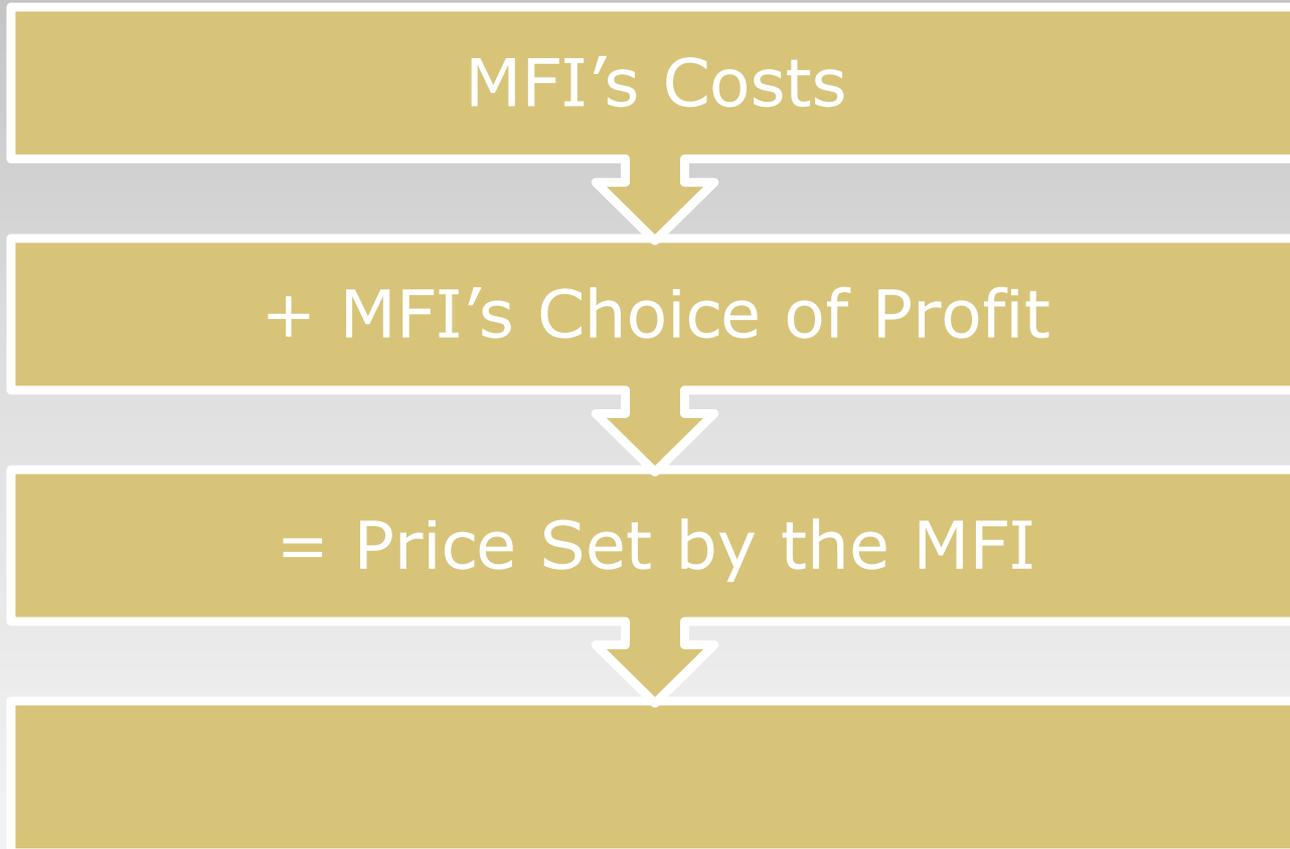
Defining a Responsible Price



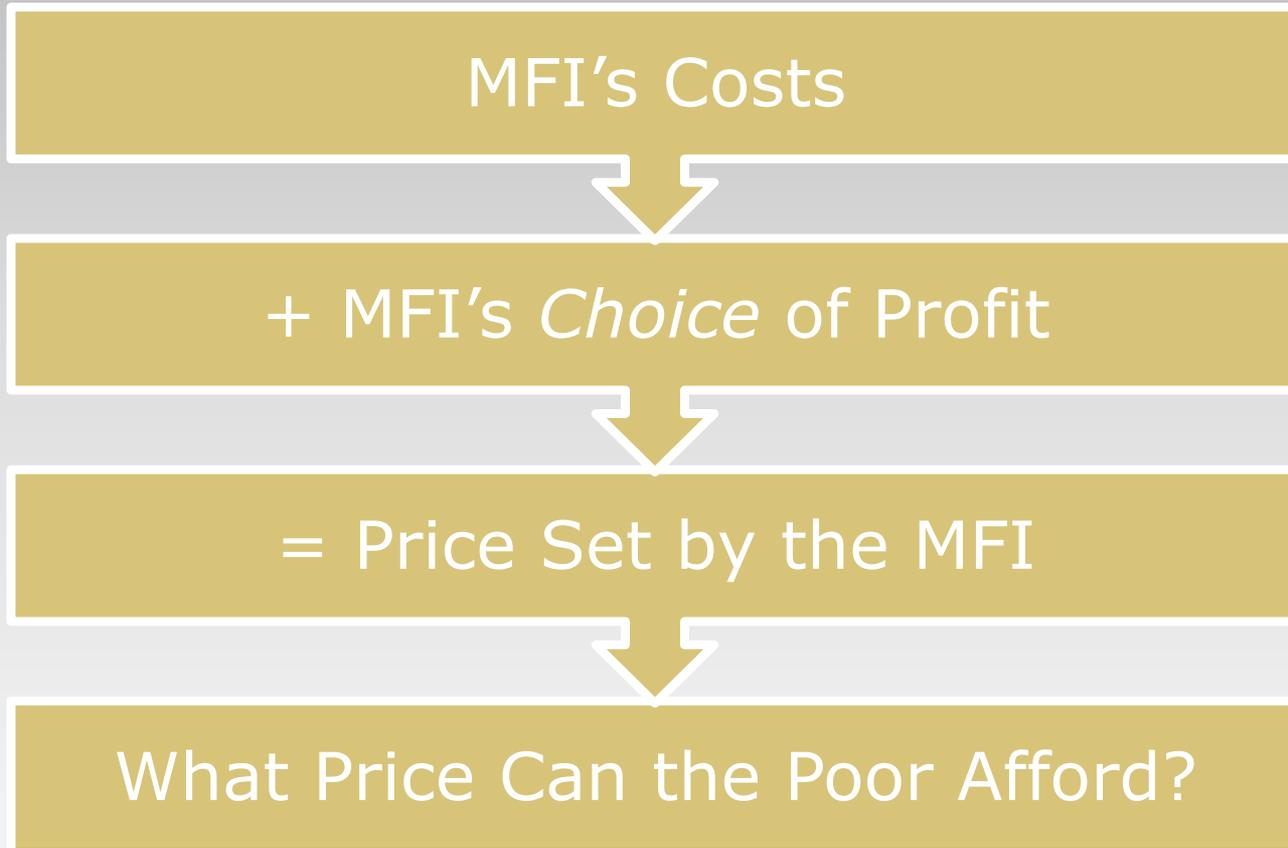
Defining a Responsible Price



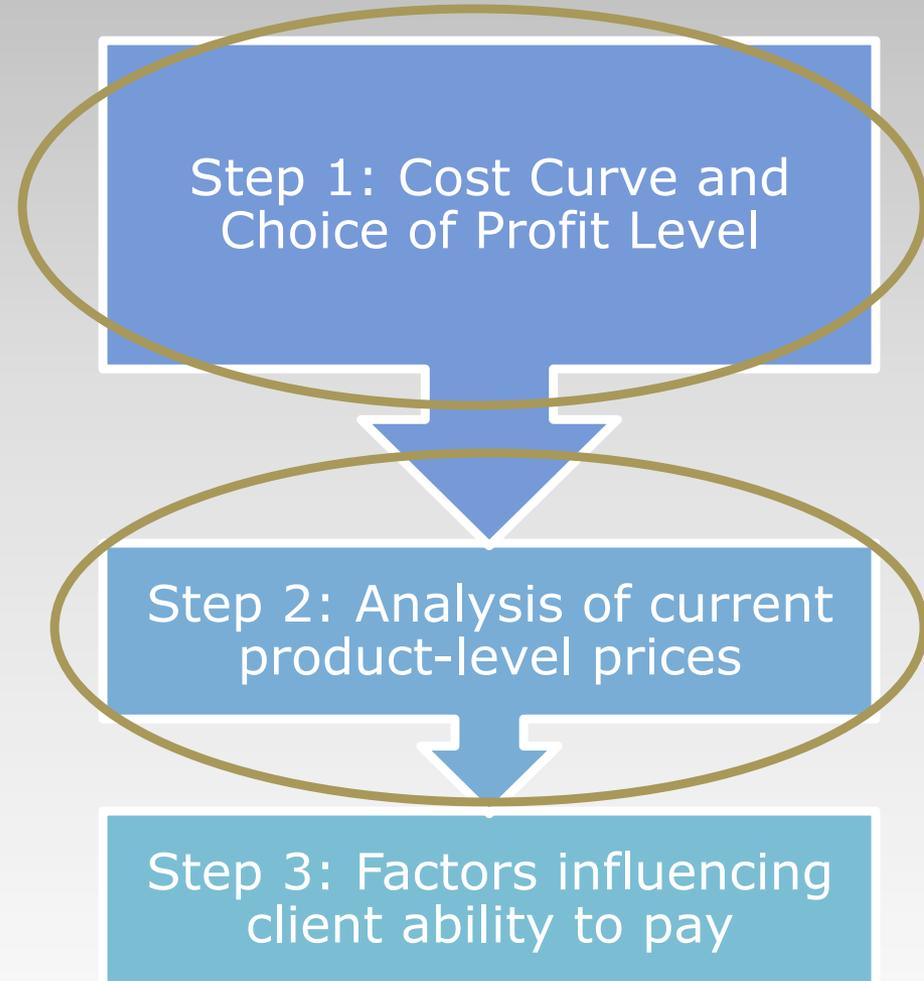
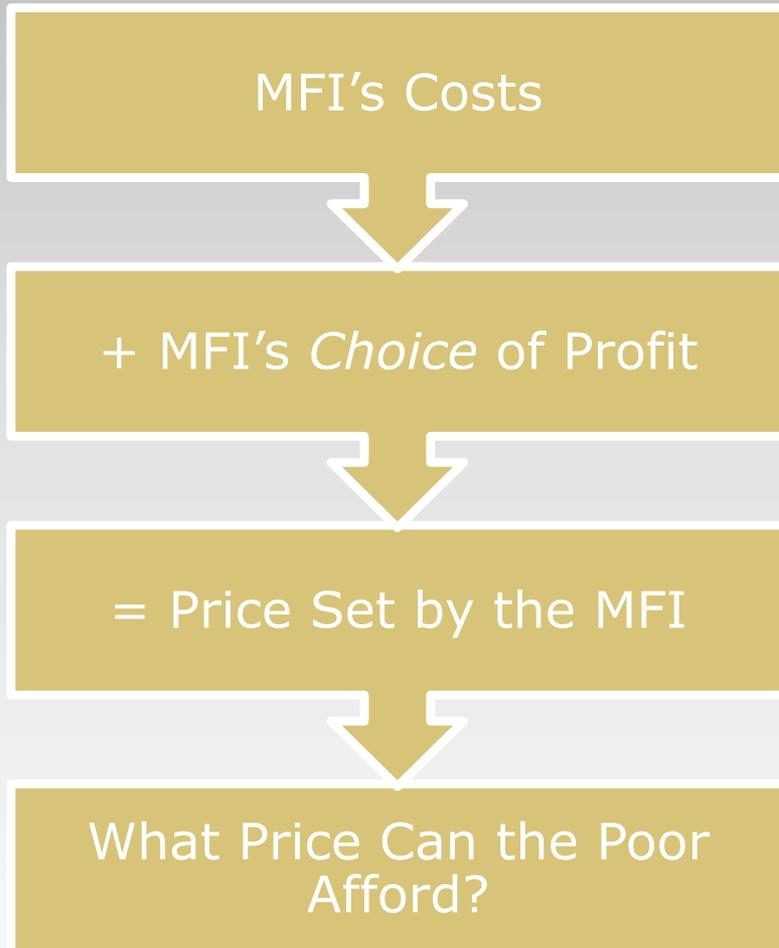
Defining a Responsible Price



Defining a Responsible Price



Defining a Responsible Price



A major challenge is PERSPECTIVE

Do we define and evaluate from:

- * the institution's perspective?**
- * the client's perspective?**
- * some difficult balance between the two?**

Institution and Client Perspectives

Institution

"Responsible" Price

Client

"Fair" Price

Institution and Client Perspectives

Institution

"Responsible" Price

Global? Product-level? Client Level?

Client

"Fair" Price

Price of the his/her loan

Institution and Client Perspectives

Institution

"Responsible" Price

Global? Product-level?
Client Level?

Bias to consider only
MFI's income

Client

"Fair" Price

Price of the his/her loan

Obligation to consider
cost from client
perspective

Institution and Client Perspectives

Institution

"Responsible" Price

Global? Product-level?
Client Level?

Bias to consider only
MFI's income

Possible to treat each
client fairly?

Client

"Fair" Price

Price of the his/her loan

Obligation to consider
cost from client
perspective

If client makes informed
decision, is it "fair"?

Pricing for Sustainability

Pricing for Profits

A Deeper Discussion of Profitability

The Institution

- Must the institution be profitable?

A Deeper Discussion of Profitability

The Institution

- Must the institution be profitable?

Each loan product

- Must each product be profitable?
- Fair for the rich to subsidize the poor?
- Fair for the poor to subsidize the rich?

A Deeper Discussion of Profitability

The Institution

- Must the institution be profitable?

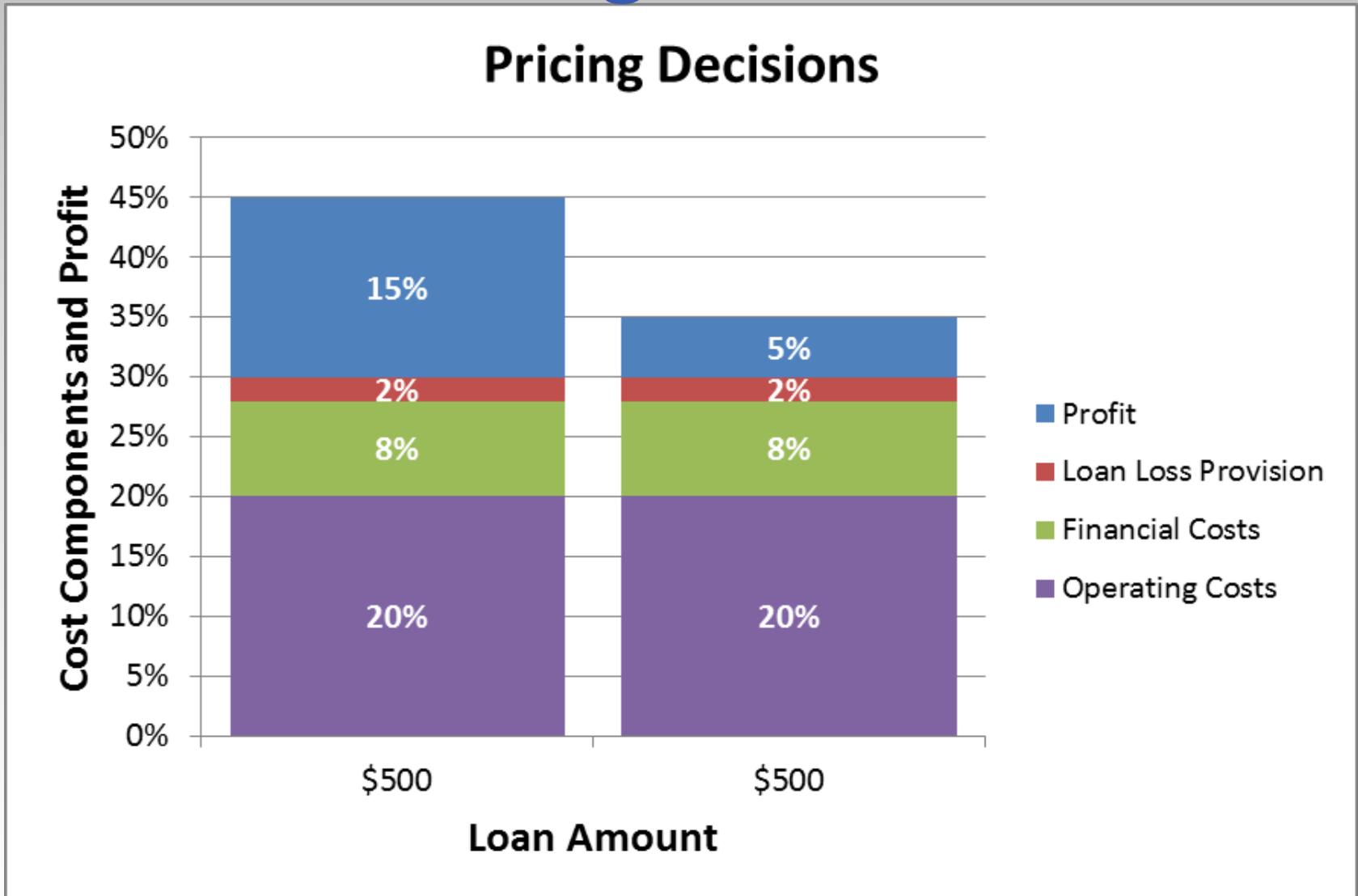
Each loan product

- Must each product be profitable?
- Fair for the rich to subsidize the poor?
- Fair for the poor to subsidize the rich?

Each client within a loan product

- Must each individual loan be profitable?
- Fair for some clients to subsidize others?

The Level of Profit is the *Choice* of Management



What do YOU think?

If your MFI is new, and your costs are therefore high, is it fair to set a high price and hide it from your clients?

What do YOU think?

Is it fair to make profits from your \$2,000 loans to subsidize your \$200 loans?

What do YOU think?

If the market is competitive for \$2,000 loans, is it fair to make high profits from \$200 loans to subsidize the \$2,000 loans?

What do YOU think?

What is the maximum profitability (ROA, not ROE) that is fair for \$5,000 loans?

- A) 2%
- B) 5%
- C) 10%
- D) 20%
- E) no limit

What do YOU think?

What is the maximum profitability (ROA, not ROE) that is fair for \$200 loans?

- A) 2%
- B) 5%
- C) 10%
- D) 20%
- E) no limit

Questions we have been ignoring for 30 years

1. What price do we really charge?
2. What price do we tell the client?
3. What is a transparent price?
4. What is a responsible price?

We really need to understand (1), (2), and (3) before we can make intelligent decisions on (4)

“The understanding of mathematics is necessary for a sound grasp of ethics.”

- Socrates

***“Only some are guilty, while all
are responsible.”***

Abraham Heschel



Promoting Transparent Pricing in the Microfinance Industry

MicroFinance Transparency is an NGO registered in the USA

