

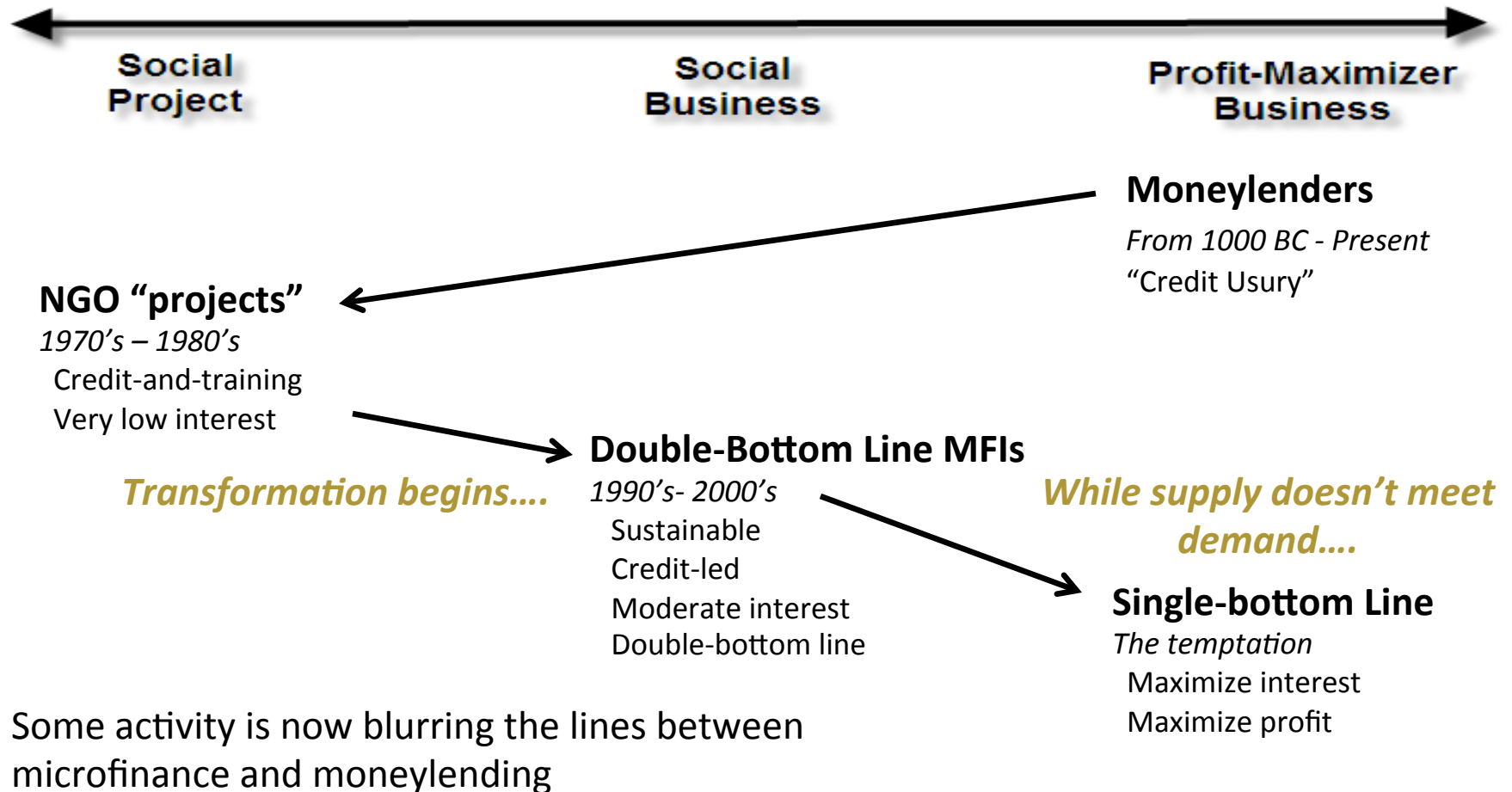
# The Importance of Consumer Protection Efforts in the Transitional Phase of Microfinance

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MicroFinance Transparency  
IDLO Responsible Regulation, Rome  
12 November 2009



# Financial Services for the Poor

## 3000 years on one slide



## Tension between Conflicting Objectives

- “Double bottom lines” are very difficult to achieve consistently. The critical question is:
  - What will be chosen between the two goals when one has to be sacrificed – profit or the poor customer?

# Pressures for Profit Maximization

“In light of what the new investors have paid for their shares, they will certainly have little sympathy for interest rate policies that do not stretch profits to the maximum.

For us, the Compartamos commercialization and IPO reinforce a message that others in the industry have been emphasizing for some time now: **those of us who are involved in MFI transformations may need to be clearer and more realistic in dealing with the inevitable governance consequences of those transformations.** When microfinance operations move from a nonprofit entity to a for-profit one, complex issues of governance, incentives, and ethics are created.”

*CGAP Focus Note, CGAP Reflections on the Compartamos IPO*

# Mission drift

- “In spite of all best intentions it is difficult to ensure that mission drift does not occur when there is money to be made. The entire body of knowledge, processes and instruments related to **corporate governance** owe their emergence to the **failure** on the part of many corporations **to resist temptation of making profits through any means.**”
  - N. Srinivasan, MFP discussion

# Staying True to Social Mission

- The challenge:
  - Even with owners committed to social mission...
  - Even with bylaws that stress social mission...
- Social mission will get compromised without some form of accountability
  - “What gets measured is what gets done”
  - Social Performance Measurement is a critical component
  - Transparency – Financial Transparency, Social Performance Transparency, and Pricing Transparency – is essential.
  - Transparency instills more accountability in decision-making.

# Business: It's all about the Price!

- MFIs are businesses
- MFIs sell products
- Products have prices
- Micro-credit prices are bewilderingly confusing
- If buyers don't know true prices, the market doesn't work
- If buyers get abused, microfinance becomes a tarnished industry
- Transparent pricing protects the poor and protects the microfinance industry

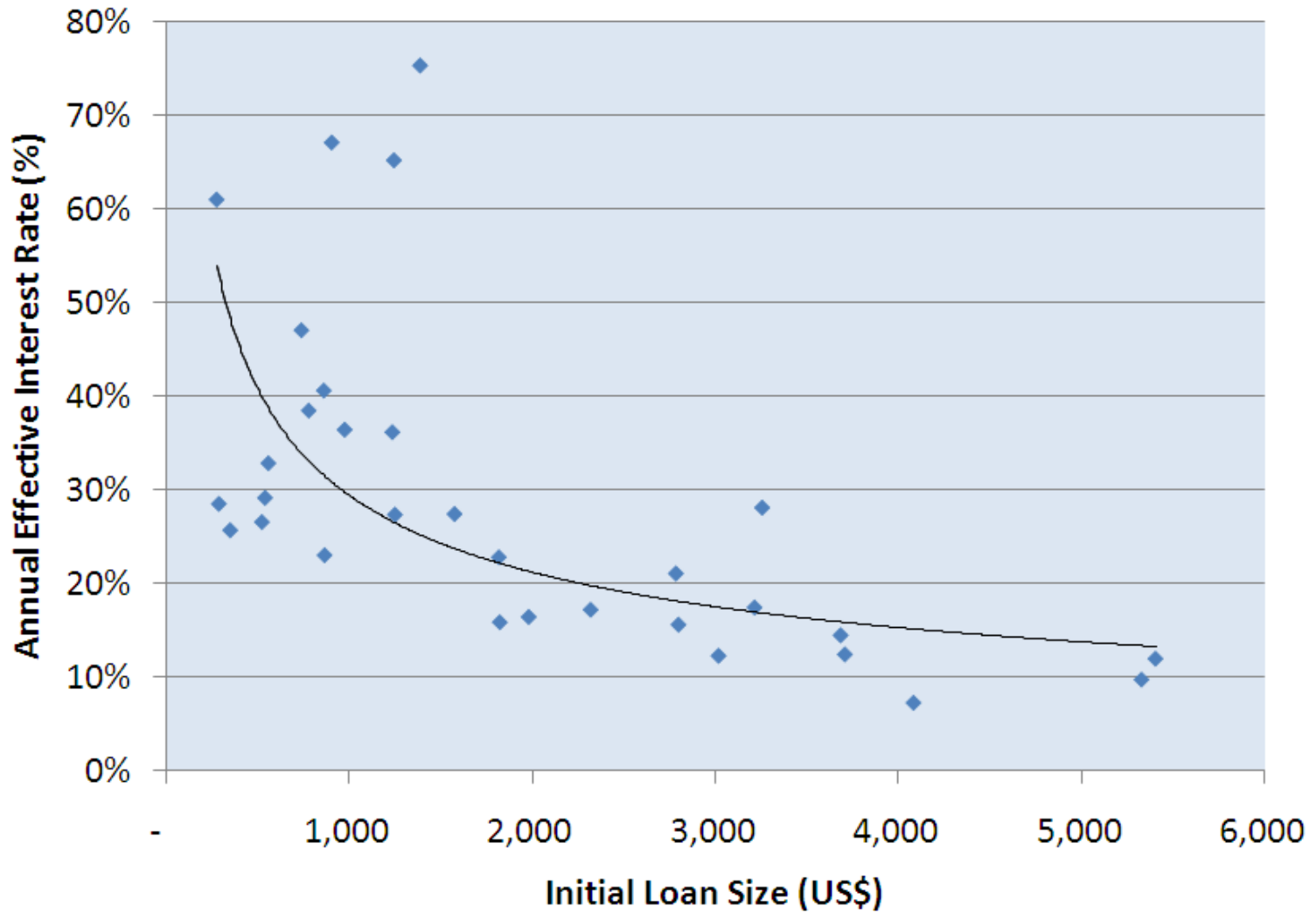
# Pricing is bewilderingly complex

- A typical example:
  - “The interest rate is 2% per month”
    - If “flat”, the “APR” is 44%
  - “We also charge a small 2% closing fee, just to cover the cost of papers”
    - If a 4-month loan, the APR is now 58%
  - “We also open a savings account for you and 15% of the loan goes into that account and we pay you 5% interest”
    - The APR is now 76%
  - The client hears 2% a month, or 24% a year, but the real price is three times higher: 76% a year
  - Transparent pricing regulation would require the business to tell the client the real price: 76%
  - In theory, with price competition, most prices would come down

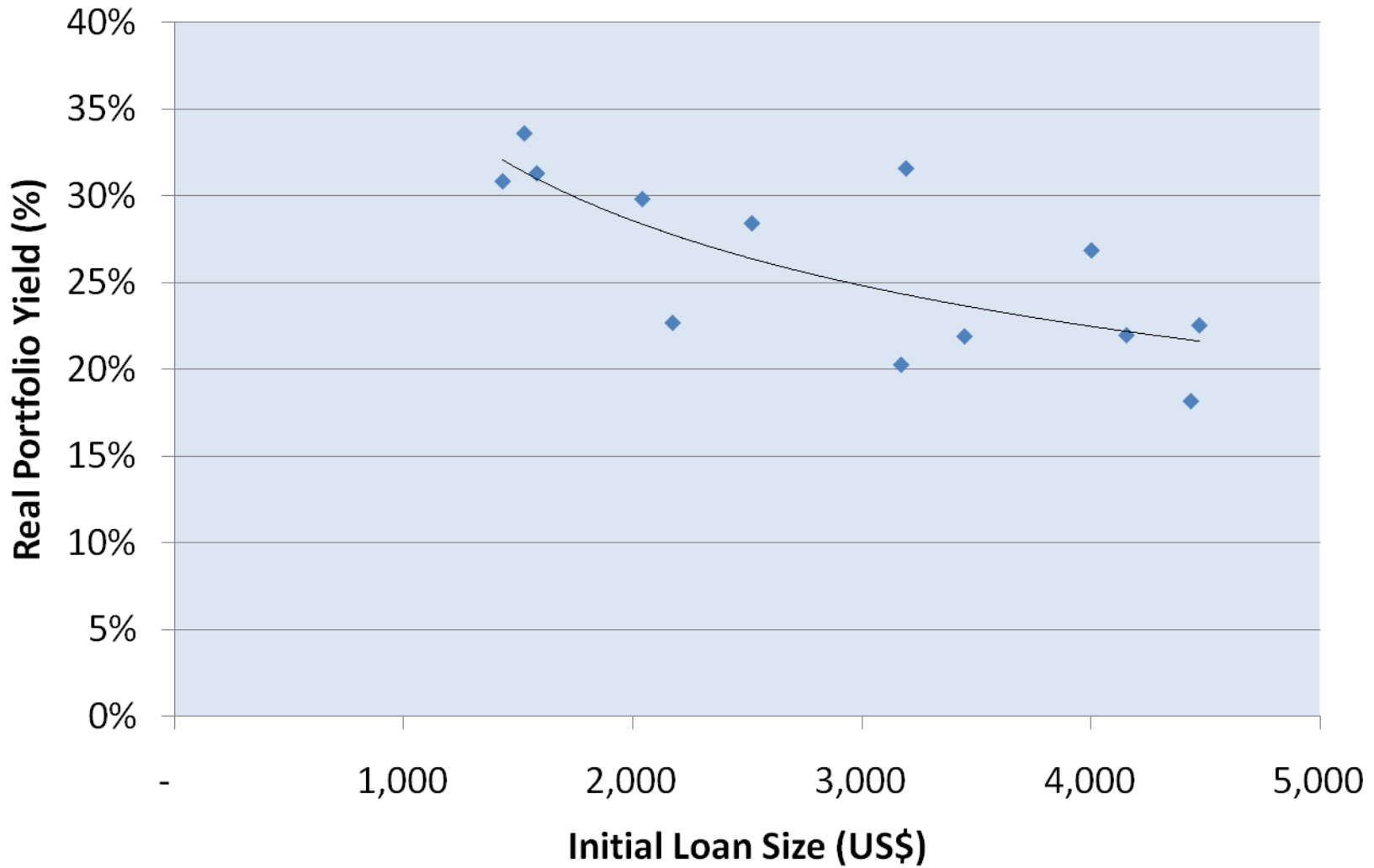




## Loan Size and Interest Rate (31 MFIs in Ecuador)

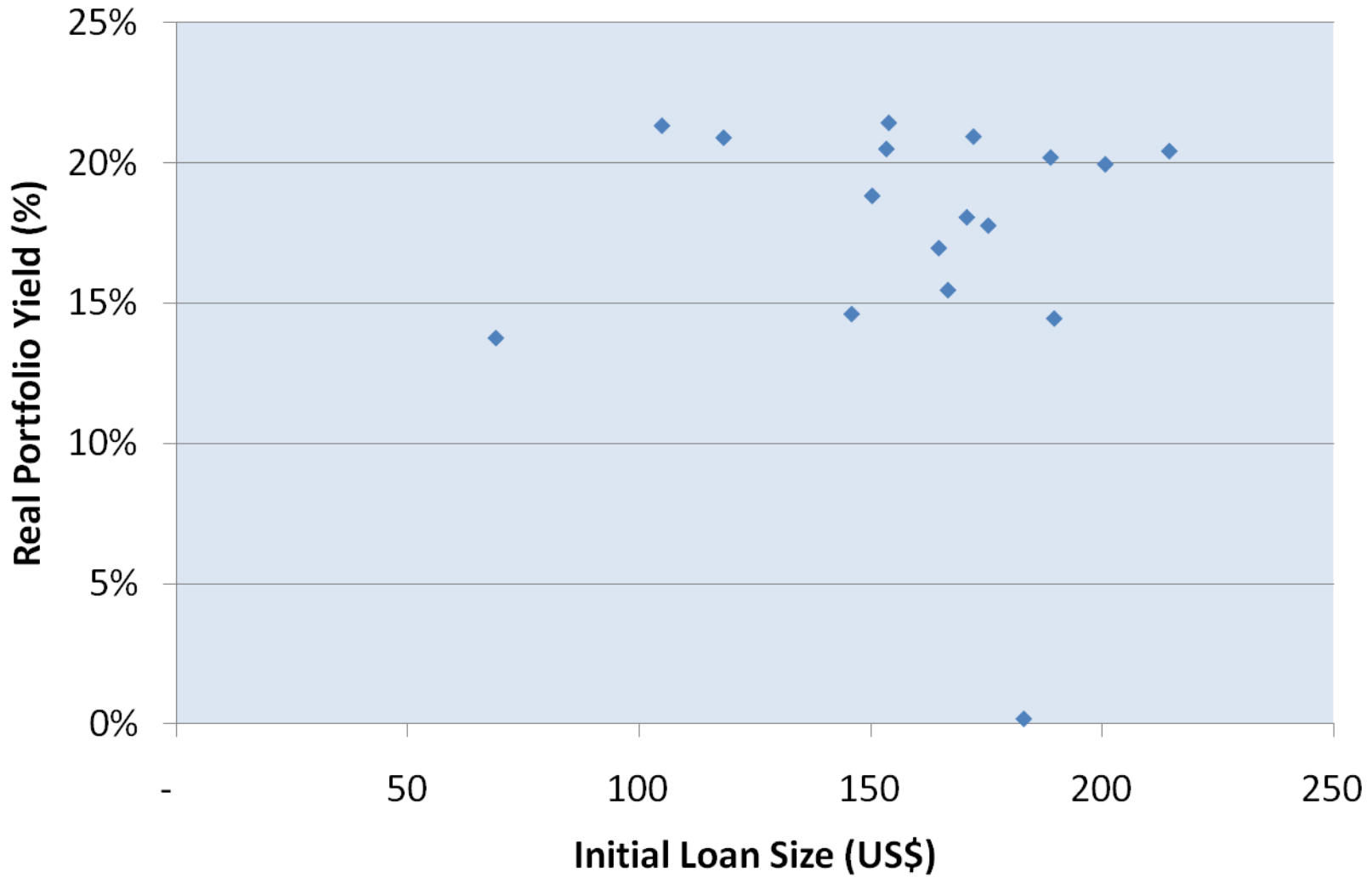


## Loan Size and Real Portfolio Yield (13 MFIs in Bosnia)

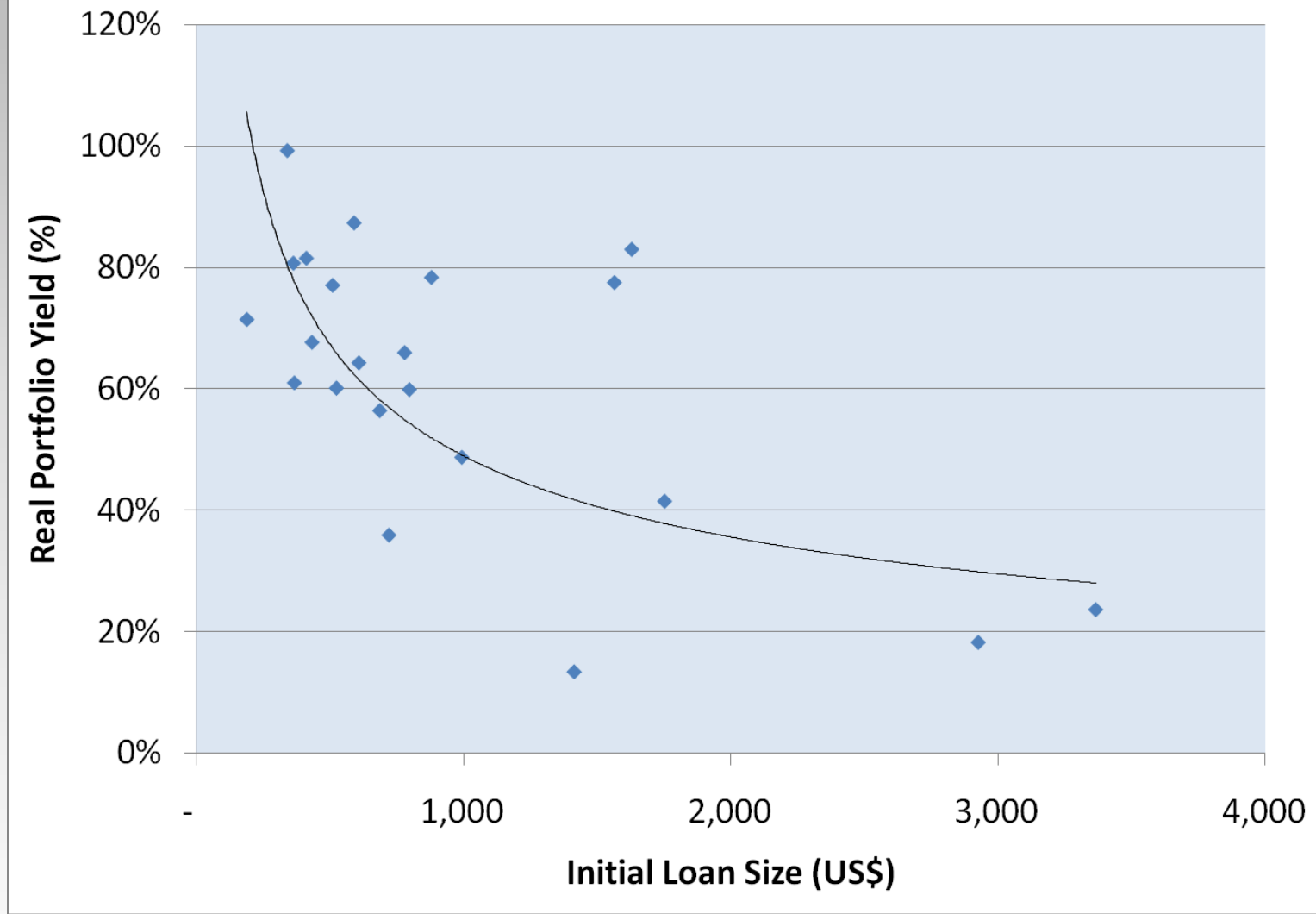


# Loan Size and Real Portfolio Yield

(17 MFIs in Bangladesh)



## Loan Size and Real Portfolio Yield (22 MFIs in Mexico)



# Innovations and Mission Drift

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