

Pricing Transparency in the Microfinance Industry

**Oikocredit
Washington DC**

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Step 1 – What do we mean by price?

What is a “transparent price”?

How should we DEFINE price?

Sign in a pub in Frankfurt Germany





FREE

WI-FI

GREAT

BEER

GREAT SERVICE

ALL DAY

WAXYS.DE

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
Interest Rate:	0%	15% “flat”	12% “flat”	40% decl
Upfront fee:	5%	2%	1%	0%
Security deposit:	0%	0%	20%	0%
TCC	\$50	\$50	\$33	\$42
APR	49%	47%	49%	40%
Transparency Index	0	32	25	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
Nominal Annual Interest Rate			12% "flat"	40% decl

Full APR			1%	0%
Security			20%	0%
Full Transparency = 100				
TCC	50	\$50	\$33	\$42
APR	49%	47%	49%	40%
Transparency Index	0	32	25	100

The Downward Spiral

1. How did prices get so confusing and non-transparent?
2. It is a combination of:
 - Lack of transparent pricing regulation
 - Initial motivation of a small minority to mask the true price
3. The result is a downward spiral drawing in nearly all MFIs

The Downward Spiral

1. All MFIs have
transparent prices

1. MFI 1:
• Interest: 2.5% decl.

2. MFI 2:
• Interest: 3.0% decl.

The Downward Spiral

1. All MFIs have transparent prices
2. **Some MFIs shift to flat interest**

1. MFI 1:
 - Interest: 2.5% decl.
2. MFI 2:
 - Interest: **2.0% flat**

The Downward Spiral

1. All MFIs have transparent prices
2. Some MFIs shift to flat interest
3. **All MFIs shift to non-transparent pricing**

1. MFI 1:
 - Interest: **1.75% flat**
2. MFI 2:
 - Interest: 2.0% flat

The Downward Spiral

1. All MFIs have transparent prices
2. Some MFIs shift to flat interest
3. **All MFIs shift to non-transparent pricing.. And it continues**

1. MFI 1:
 - Interest: 1.75% flat
2. MFI 2:
 - Interest: **1.6% flat, 2% upfront fee**

The Downward Spiral

1. All MFIs have transparent prices
2. Some MFIs shift to flat interest
3. All MFIs shift to non-transparent pricing
4. **Consumers struggle to choose.... Which would YOU choose?**

1. MFI 1:
 - Interest: 1.75% flat
2. MFI 2:
 - Interest: 1.6% flat, 2% upfront fee

The Downward Spiral

1. All MFIs have transparent prices
2. Some MFIs shift to flat interest
3. All MFIs shift to non-transparent pricing
4. **Consumers struggle to choose... Because the prices are far from clear**

1. MFI 1:
 - Interest: 1.75% flat
 - **APR: 37%**
2. MFI 2:
 - Interest: 1.6% flat, 2% upfront fee
 - **APR: 57%**

The Downward Spiral

1. All MFIs have transparent prices
2. Some MFIs shift to flat interest
3. All MFIs shift to non-transparent pricing
4. Consumers struggle to choose
5. **Profits are correlated to price when loans are identical**

1. MFI 1:
 - Interest: 1.75% flat
 - APR: 37%
 - **ROE: 10%**
2. MFI 2:
 - Interest: 1.6% flat, 2% upfront fee
 - APR: 57%
 - **ROE: 40%**

The Downward Spiral

1. Prices are far from clear, and thus:
 - Consumers over-consume
 - Market competition is hindered
 - Strong temptation from high profits
 - The poor are harmed
 - Public image is tarnished
 - Governments urged to intervene
2. Transparency, and particularly pricing transparency, is a key element to correct this serious problem in the microfinance industry

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.

Step 2: What Prices Do We Charge?

Cardinal Rule in analyzing micro-loans:

Never use averages

Are Microcredit Interest Rates Excessive?

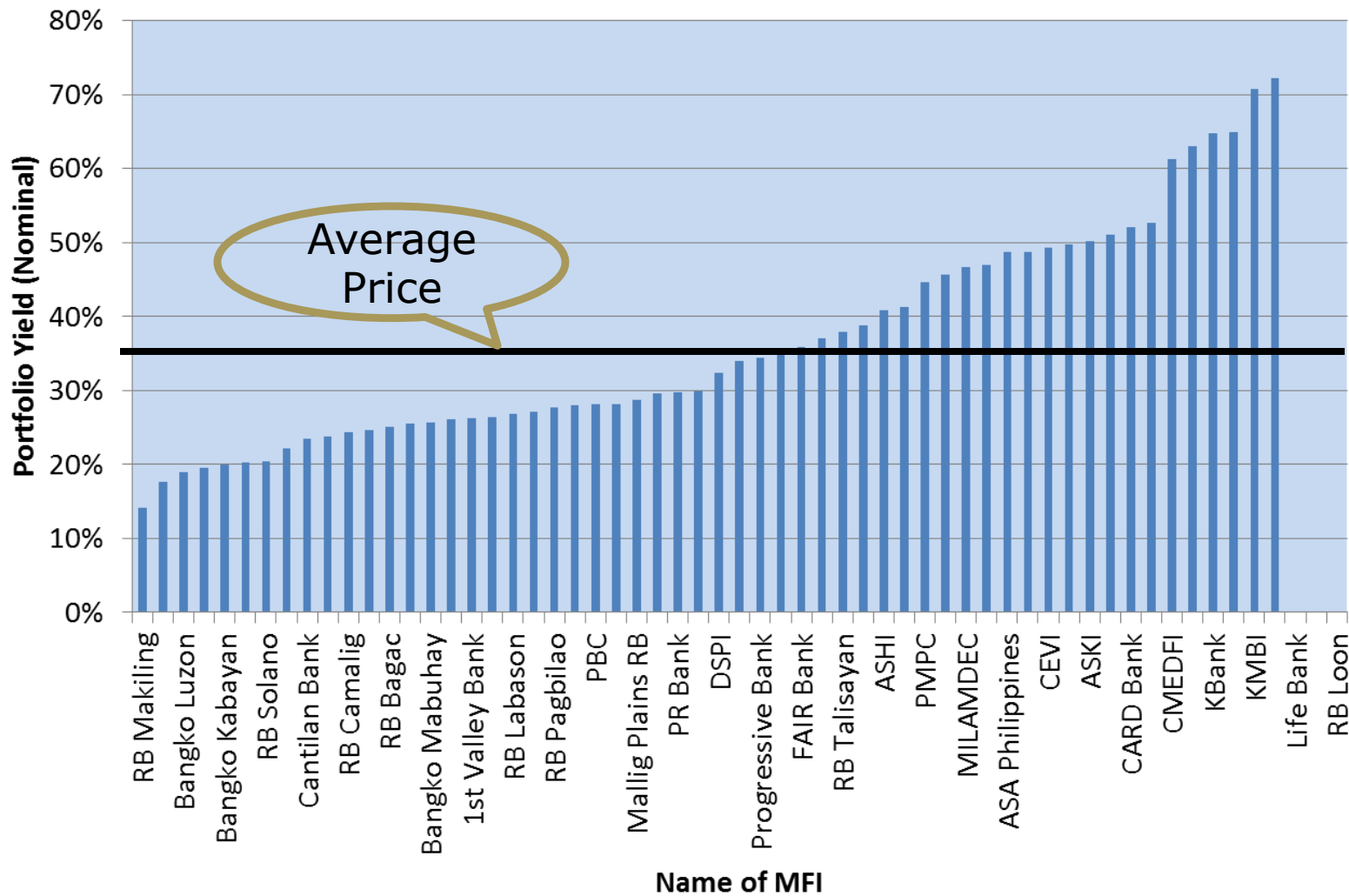
Over the past two decades, institutions in developing and transition economies have argued that microcredit operations are financially sustainable only if they cover all their costs. They argue that covering all costs is necessary for the sustainability of the services they provide. Supporters argue that microcredit can continue to serve their clients without subsidies and fund exponential growth of service, including deposits from the public.

The problem is that administrative costs are inevitably higher for tiny microloans than for normal bank lending. For instance,

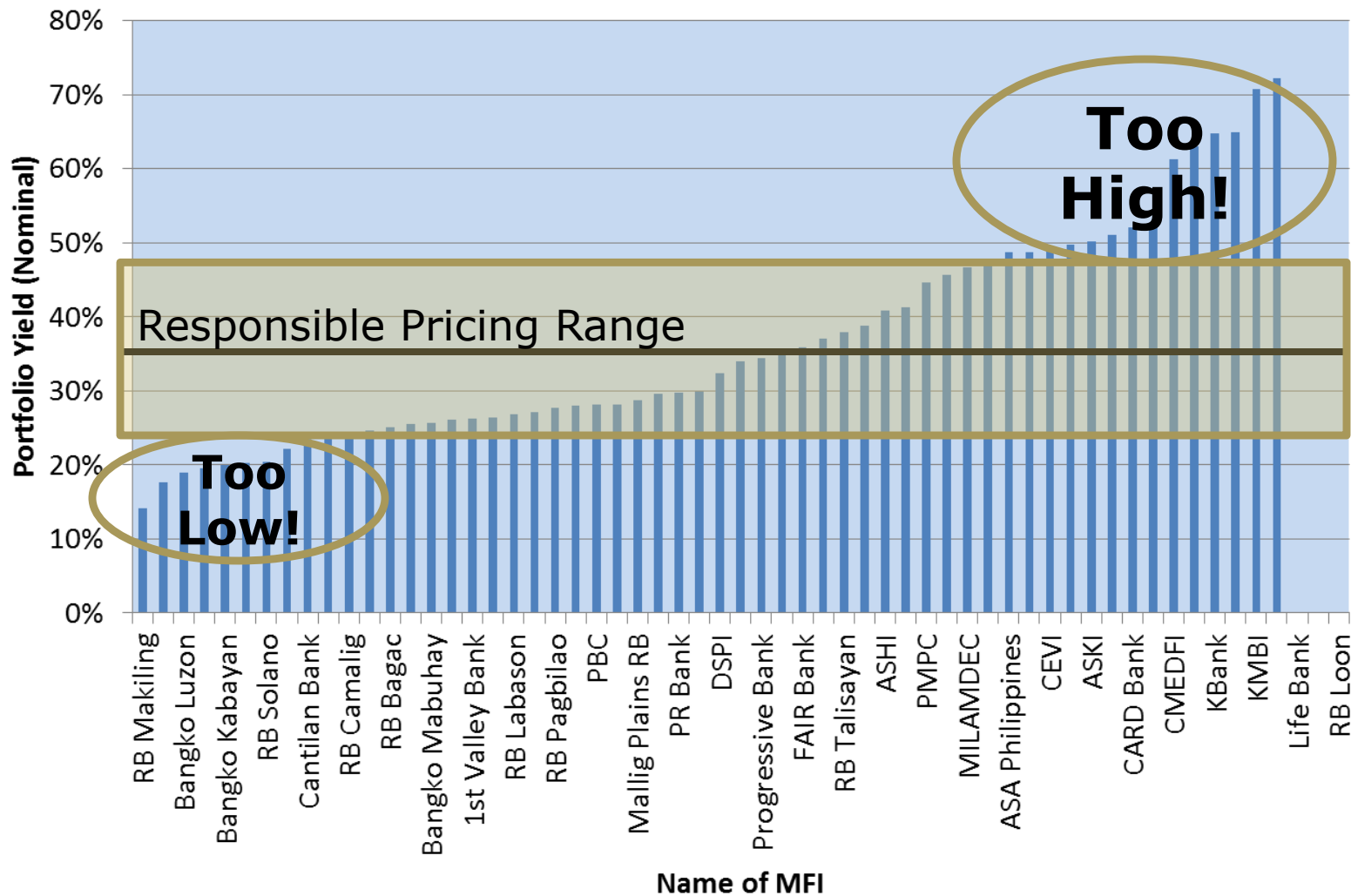
Interest rate levels

- Based on the best data available, the median interest rate for sustainable (i.e., profitable) MFIs was about 26 percent in 2006. The 85 percent interest rates that drew so much attention to the Mexican MFI Compartamos are truly exceptional, rather than representative of the industry. Less than 1 percent of borrowers pay rates that high.
- MFI interest rates declined by 2.3 percentage points a year between 2003 and 2006, much faster than bank rates.

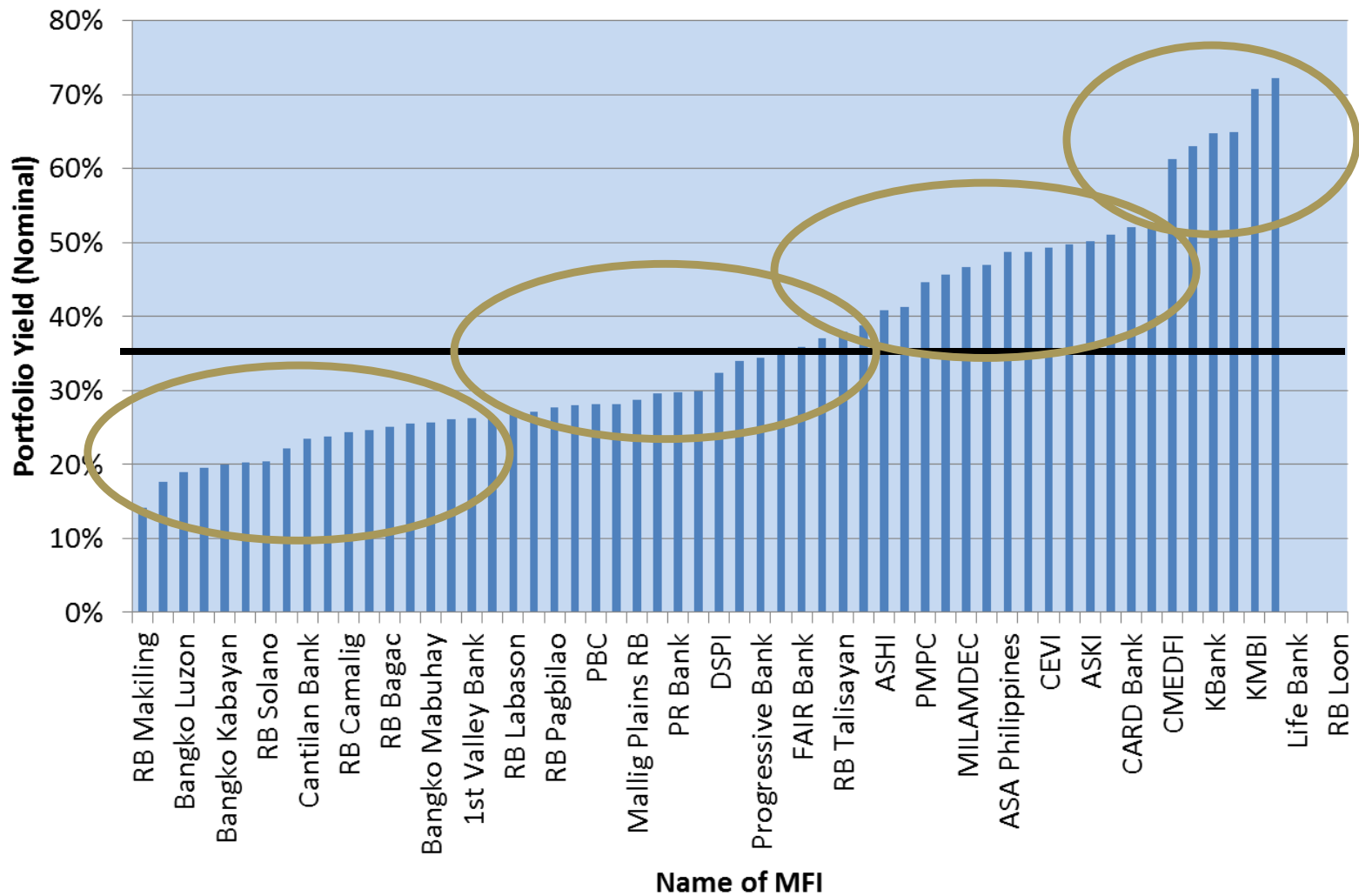
Portfolio Yield by MFI Philippines, 59 MFIs



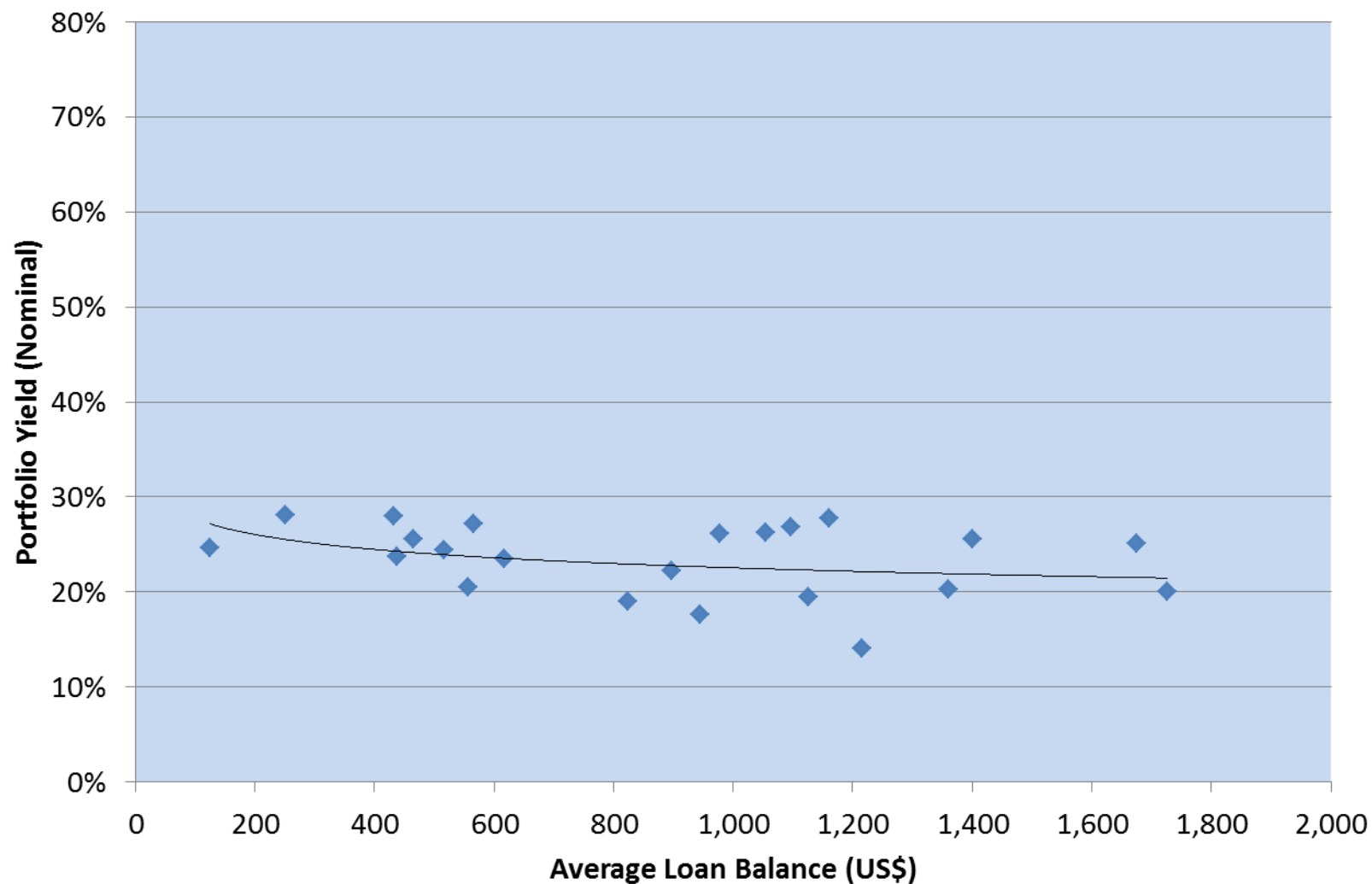
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Portfolio Yield by MFI Philippines, 59 MFIs



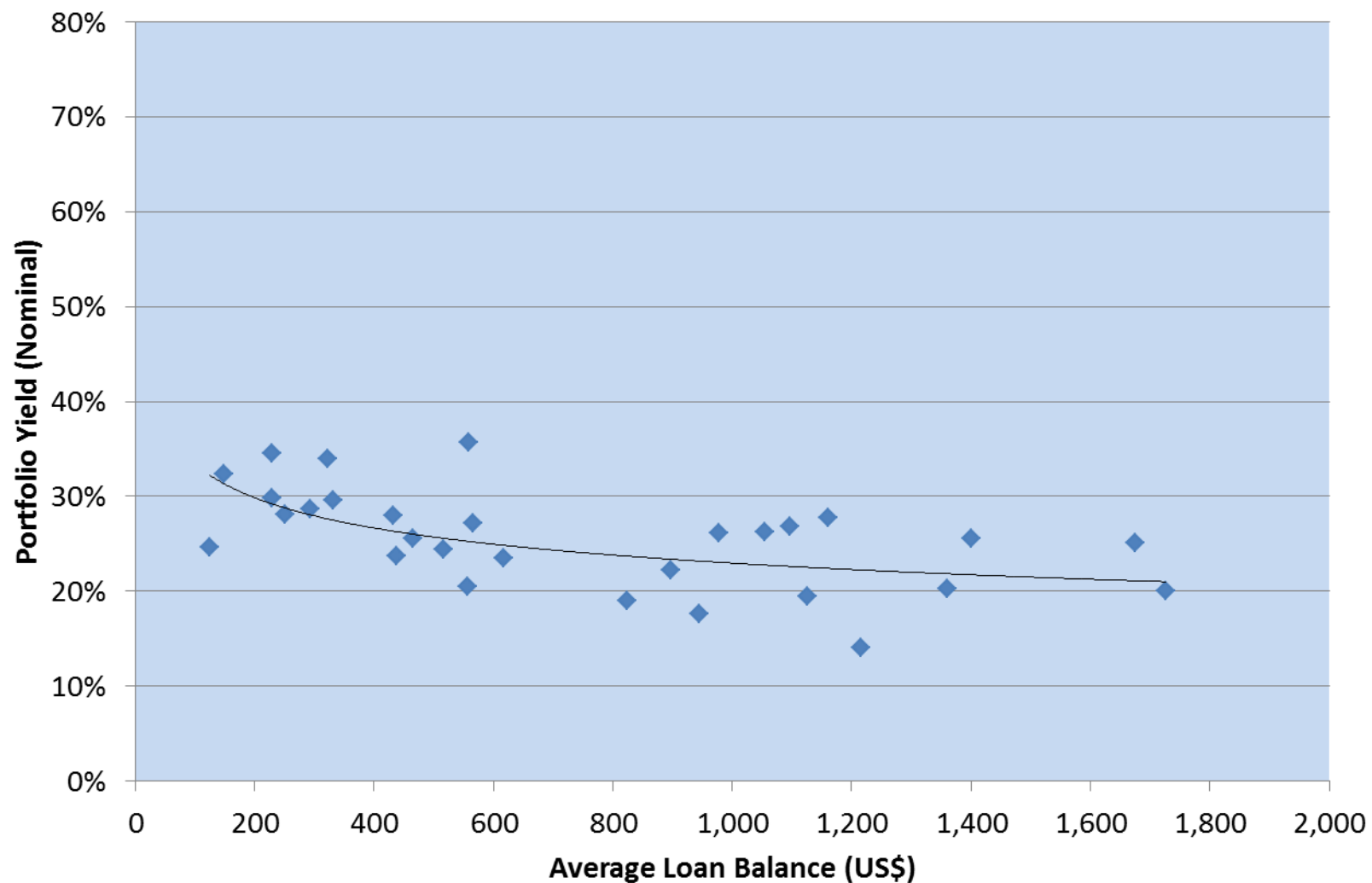
Portfolio Yield vs Average Loan Balance Philippines, 24 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

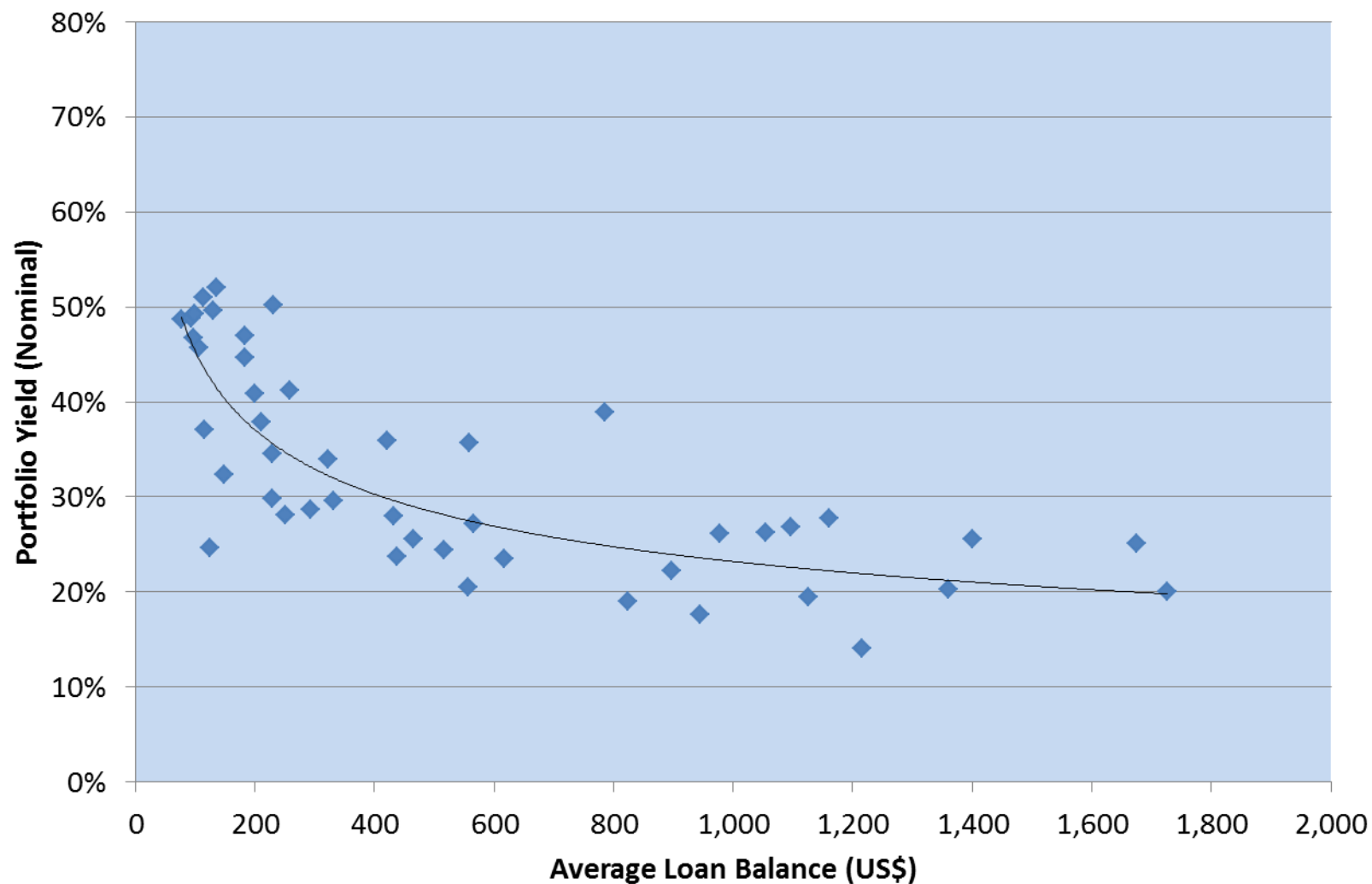
Portfolio Yield vs Average Loan Balance Philippines, 32 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

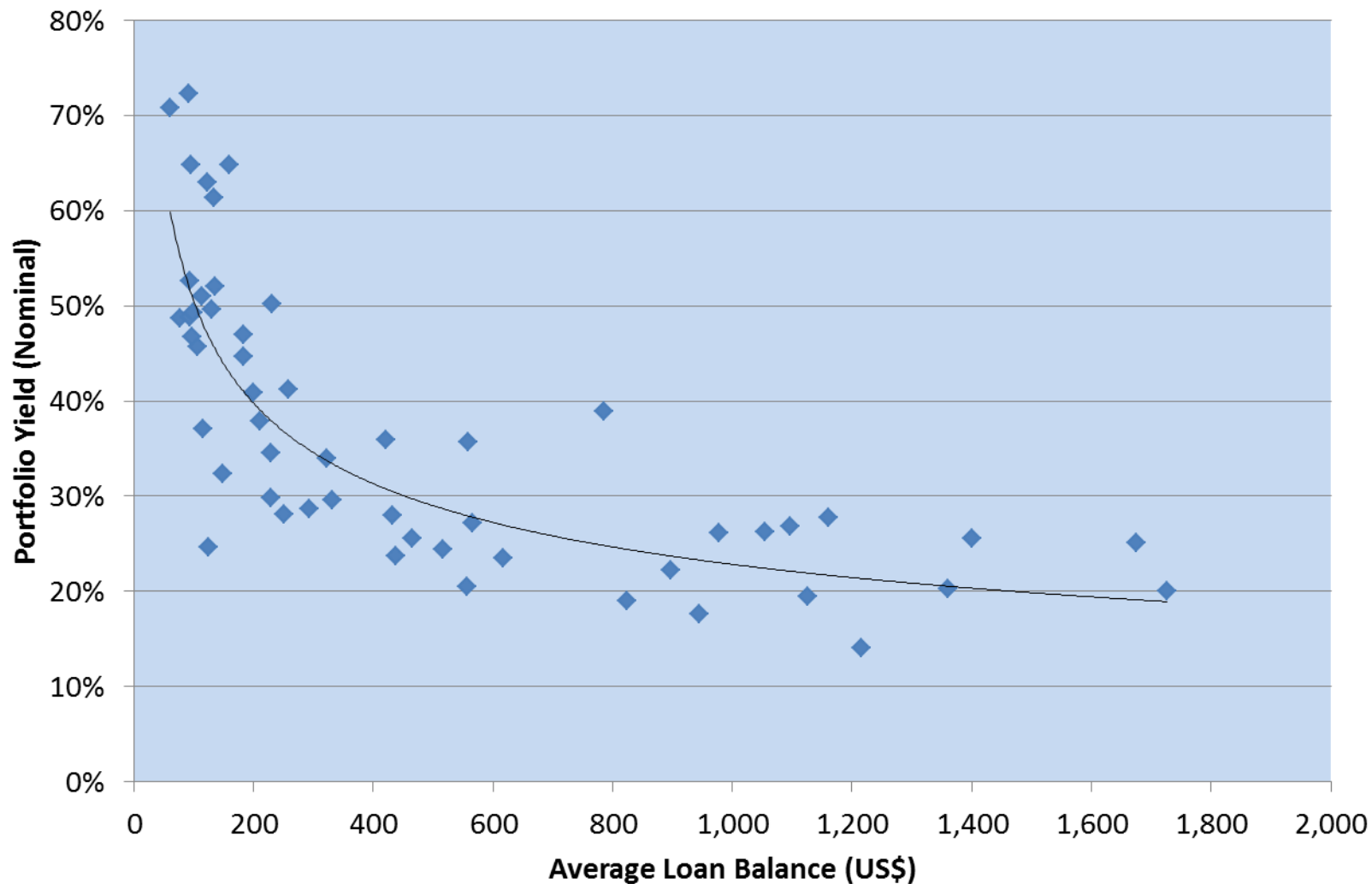
Portfolio Yield vs Average Loan Balance Philippines, 49 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

Portfolio Yield vs Average Loan Balance Philippines, 59 MFIs



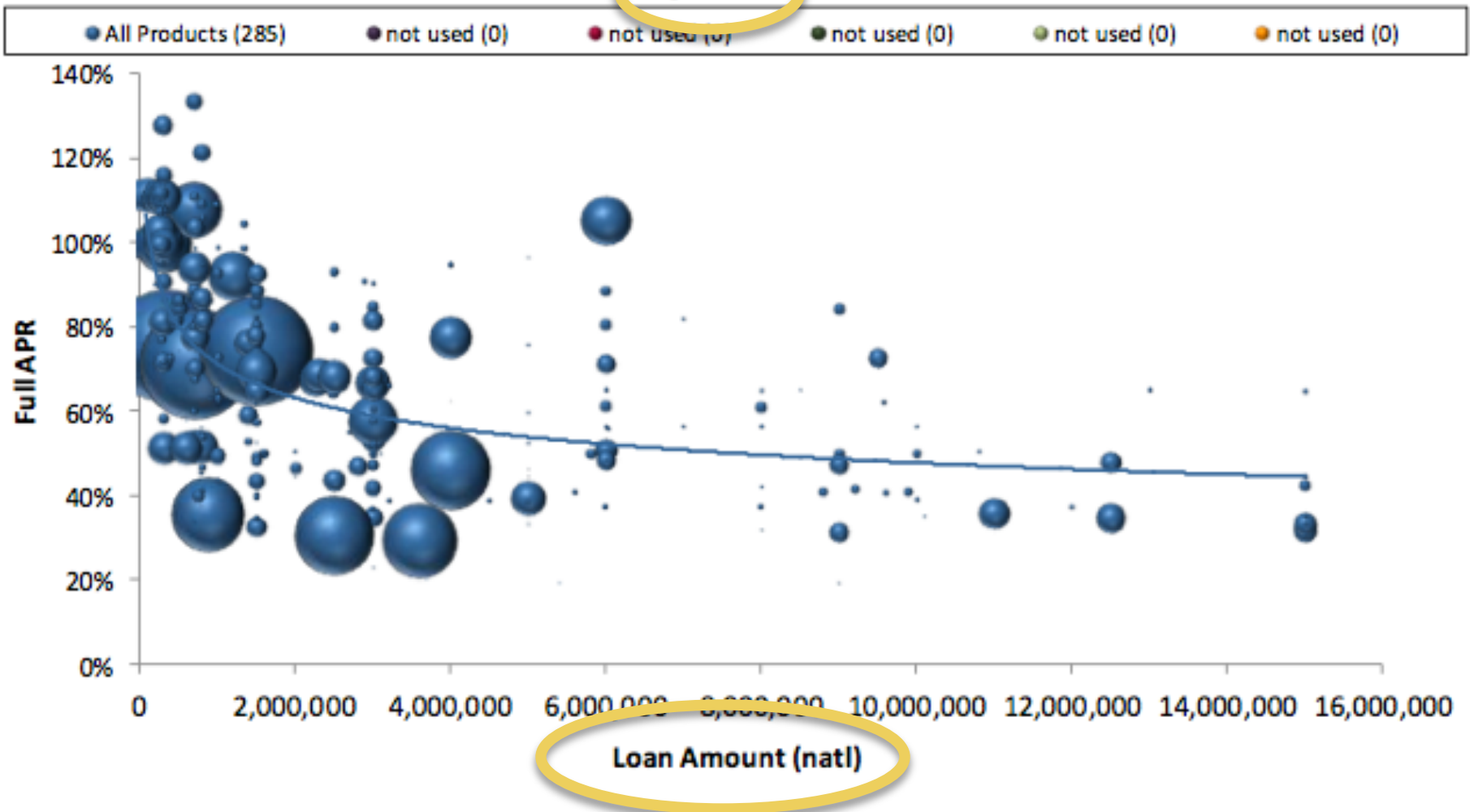
- ◆ Portfolio Yield vs Average Loan Balance

—— Power (Portfolio Yield vs Average Loan Balance)

Moving beyond PORTFOLIO YIELD to ACTUAL PRICES

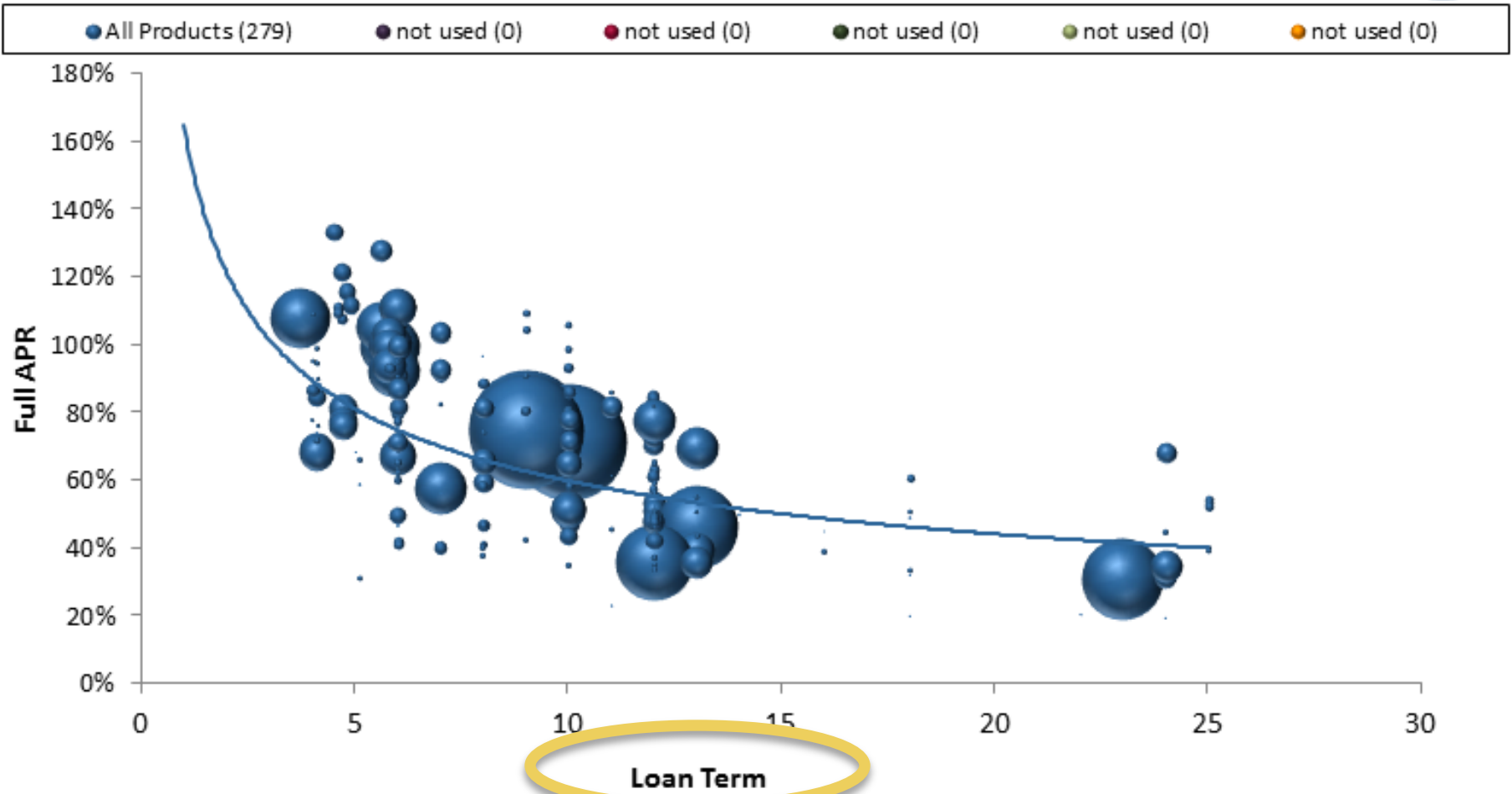
Full APR compared to Loan Amount (natl)

Country: Uganda, Date: 26-Jul-2013



Full APR compared to Loan Term
Country: Uganda, Date: 05-Sep-2013

clients



Filtered for: Max Loan Term <30, Clients >50, Total Data Points: 279

Full APR compared to Loan Amount (natl)

Country: India, Date: 05-Sep-2013

clients

● All Products (281)

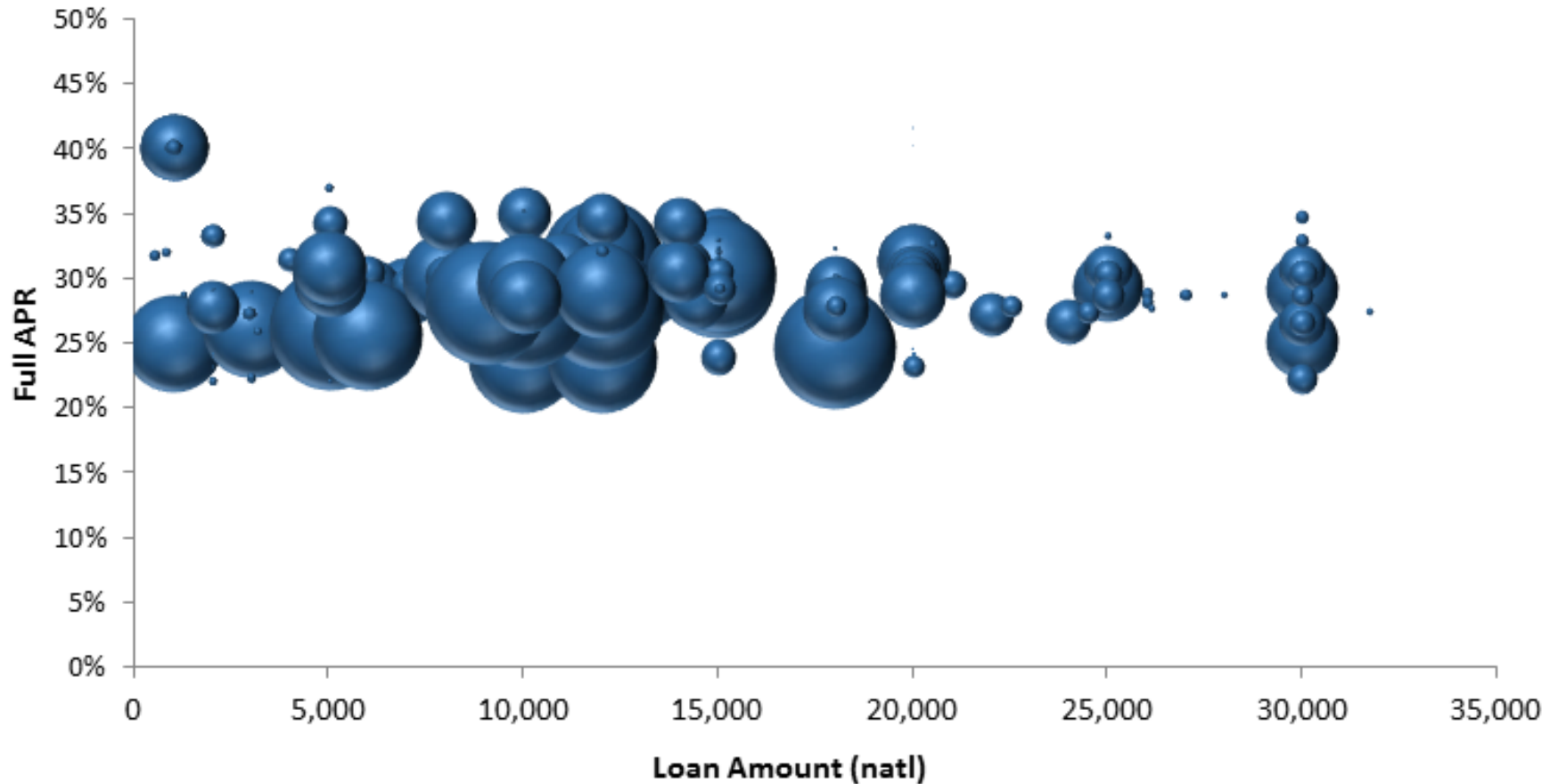
● not used (0)

● not used (0)

● not used (0)

● not used (0)

● not used (0)



Filtered for: Max Loan Amount <35,000, Prices <80%, Clients >50, Total Data Points: 281

Step 3: How Honest are We about our Prices

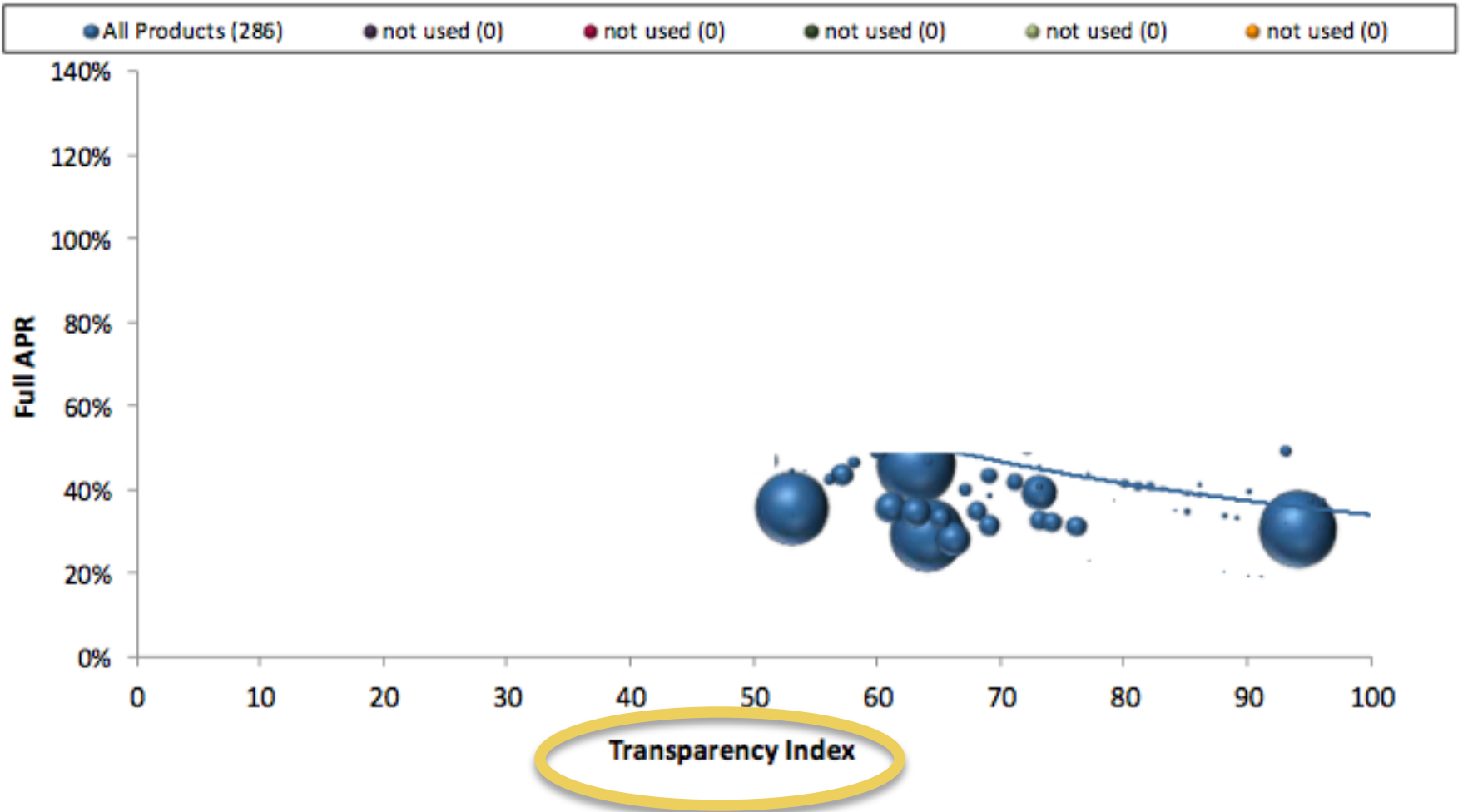
**The Transparency Curve and the
Combinations of Charges We Use**

Which loan would you pick?

	Zero Interest Loan	Interest and Fees	And Savings	Interest Only
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Interest rate:	Nominal Annual Interest Rate ----- Full APR		12% "flat"	40% <u>decl</u>
Security:	Full Transparency = 100		1%	0%
TCC	\$0	\$50	\$33	\$42
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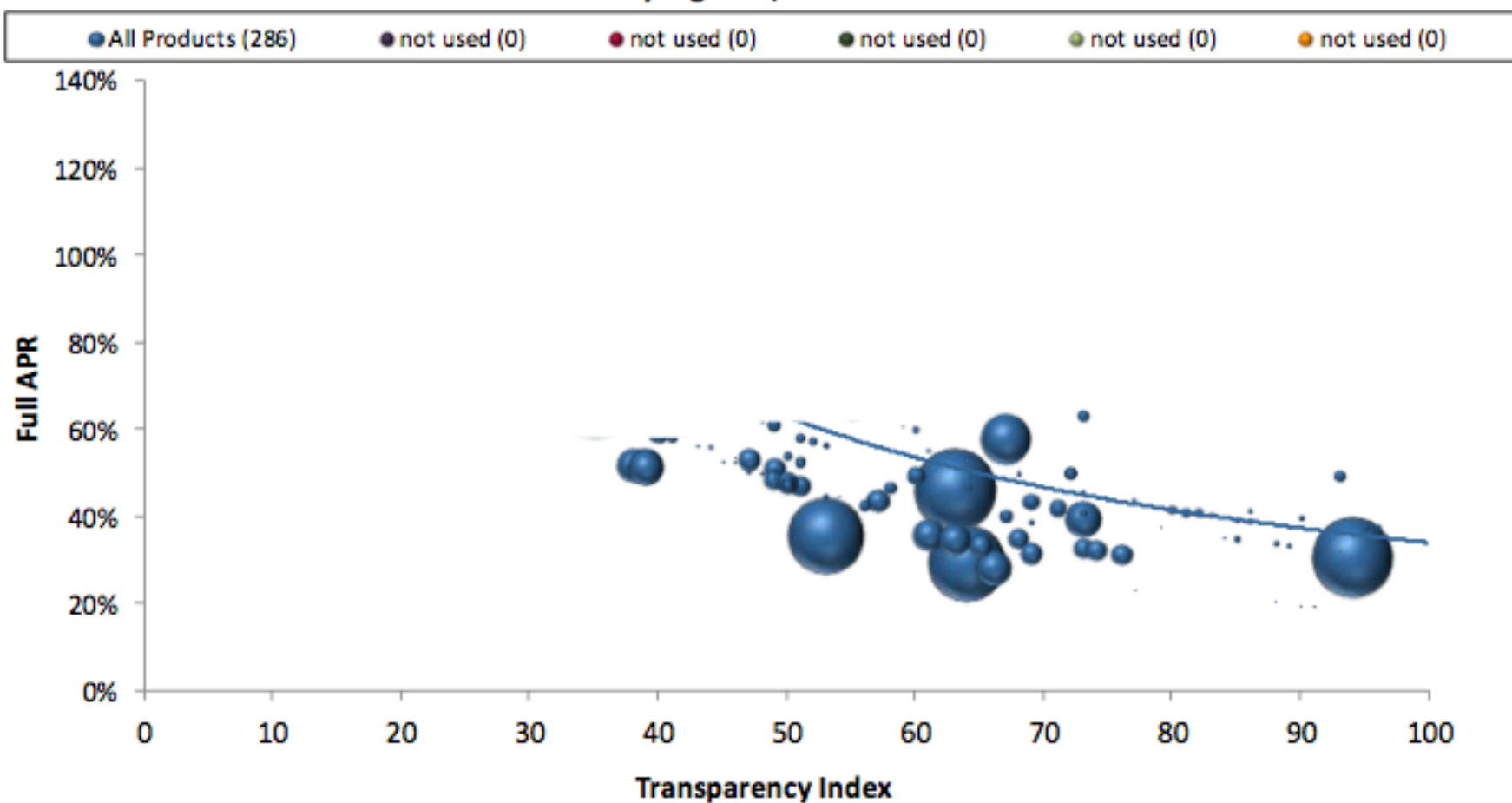
Full APR compared to Transparency Index

Country: Uganda, Date: 26-Jul-2013



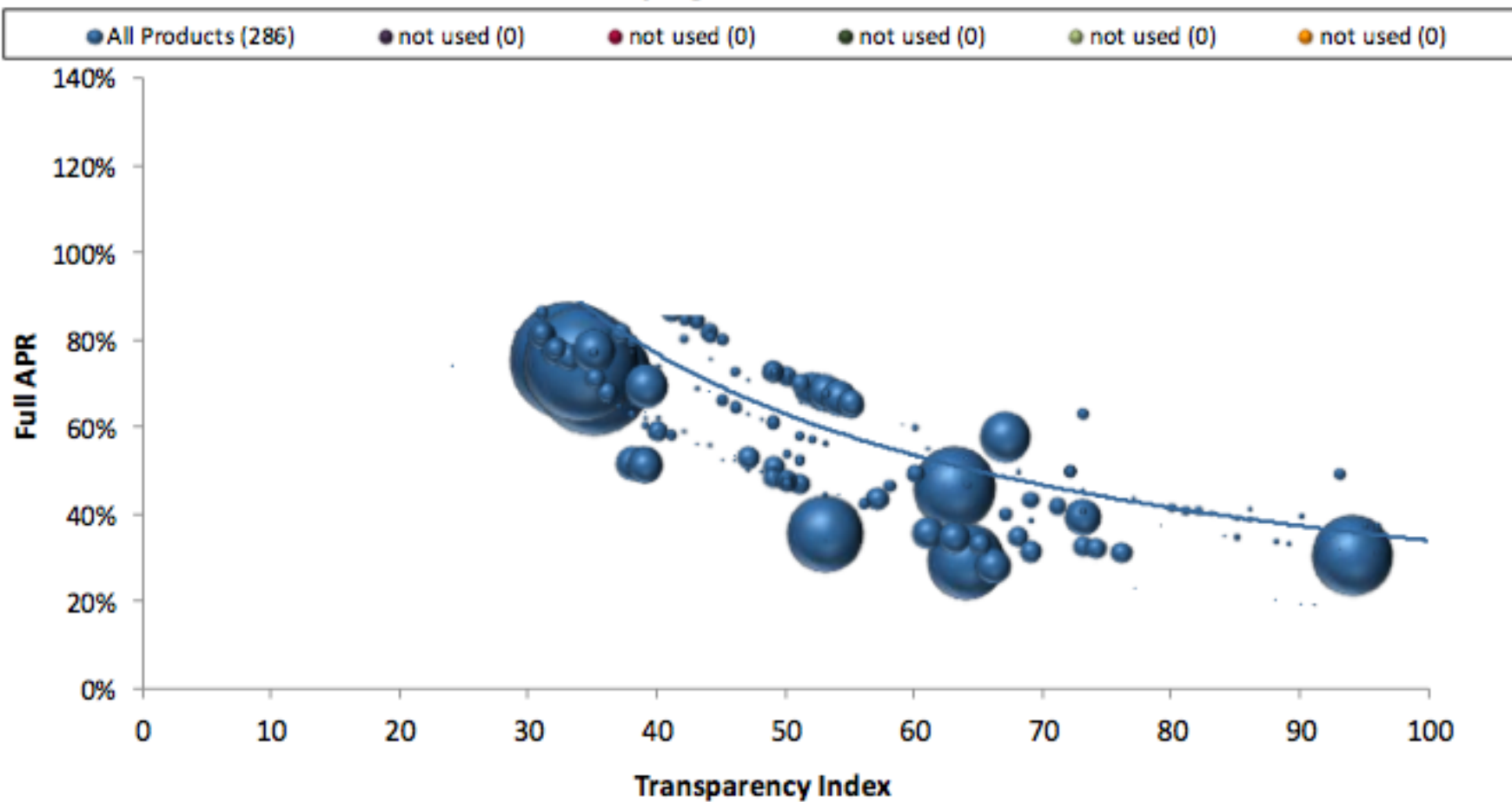
Full APR compared to Transparency Index

Country: Uganda, Date: 26-Jul-2013

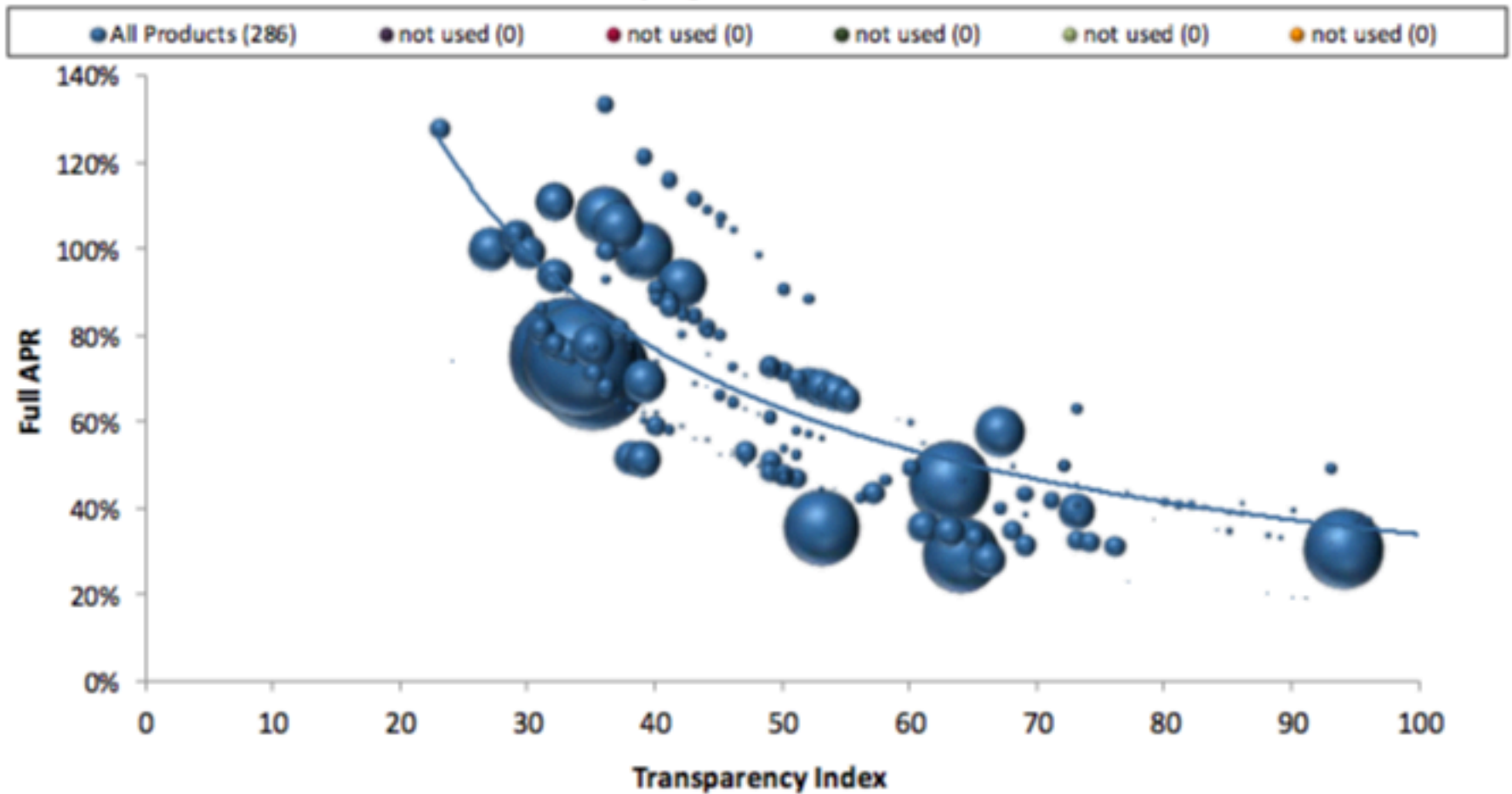


Full APR compared to Transparency Index

Country: Uganda, Date: 26-Jul-2013

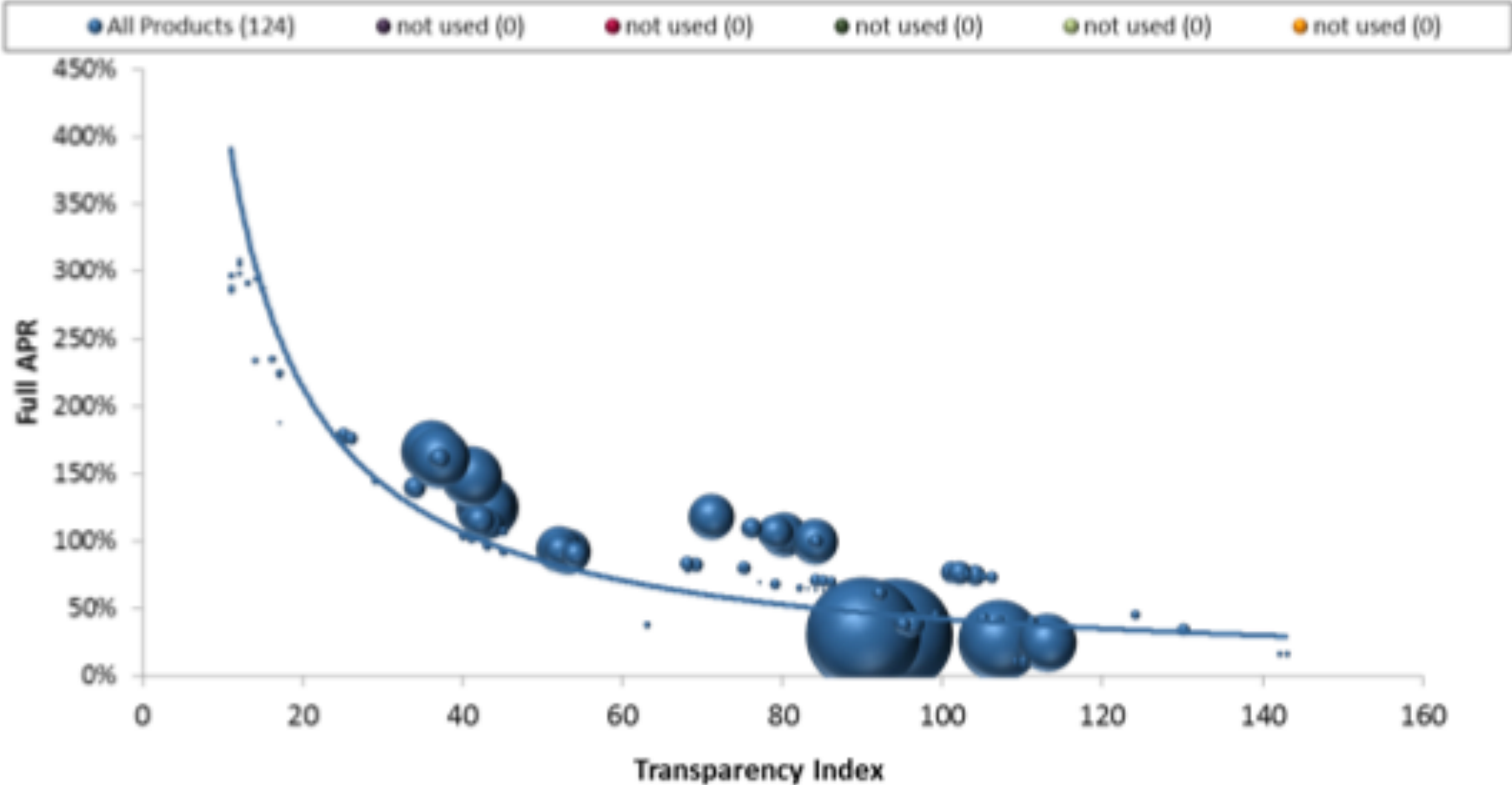


Full APR compared to Transparency Index
Country: Uganda, Date: 26-Jul-2013



Full APR compared to Transparency Index
Country: Malawi, Date: 25-Jul-2013

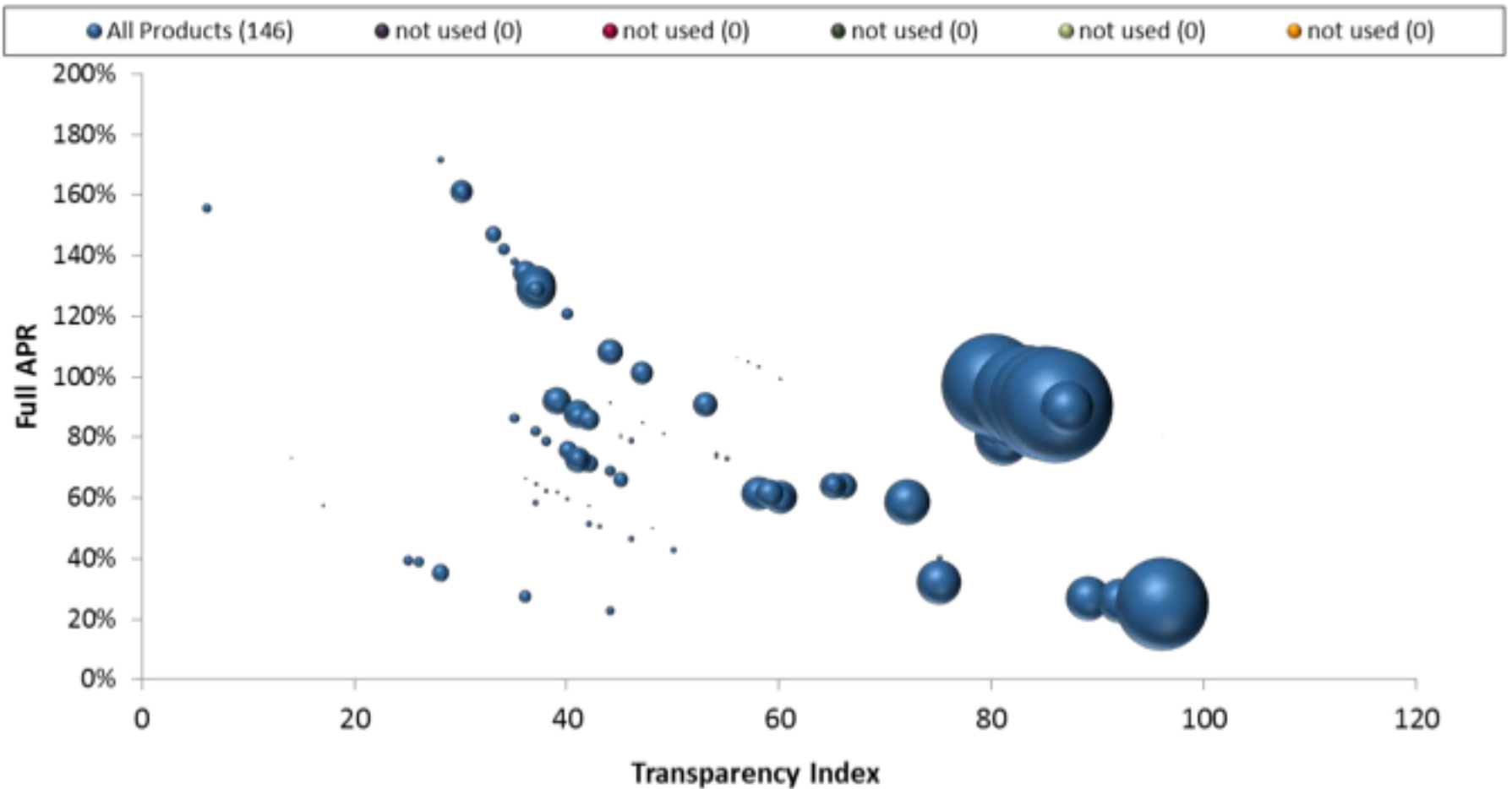
clients



Filtered for: Clients >50, Total Data Points: 124

Full APR compared to Transparency Index

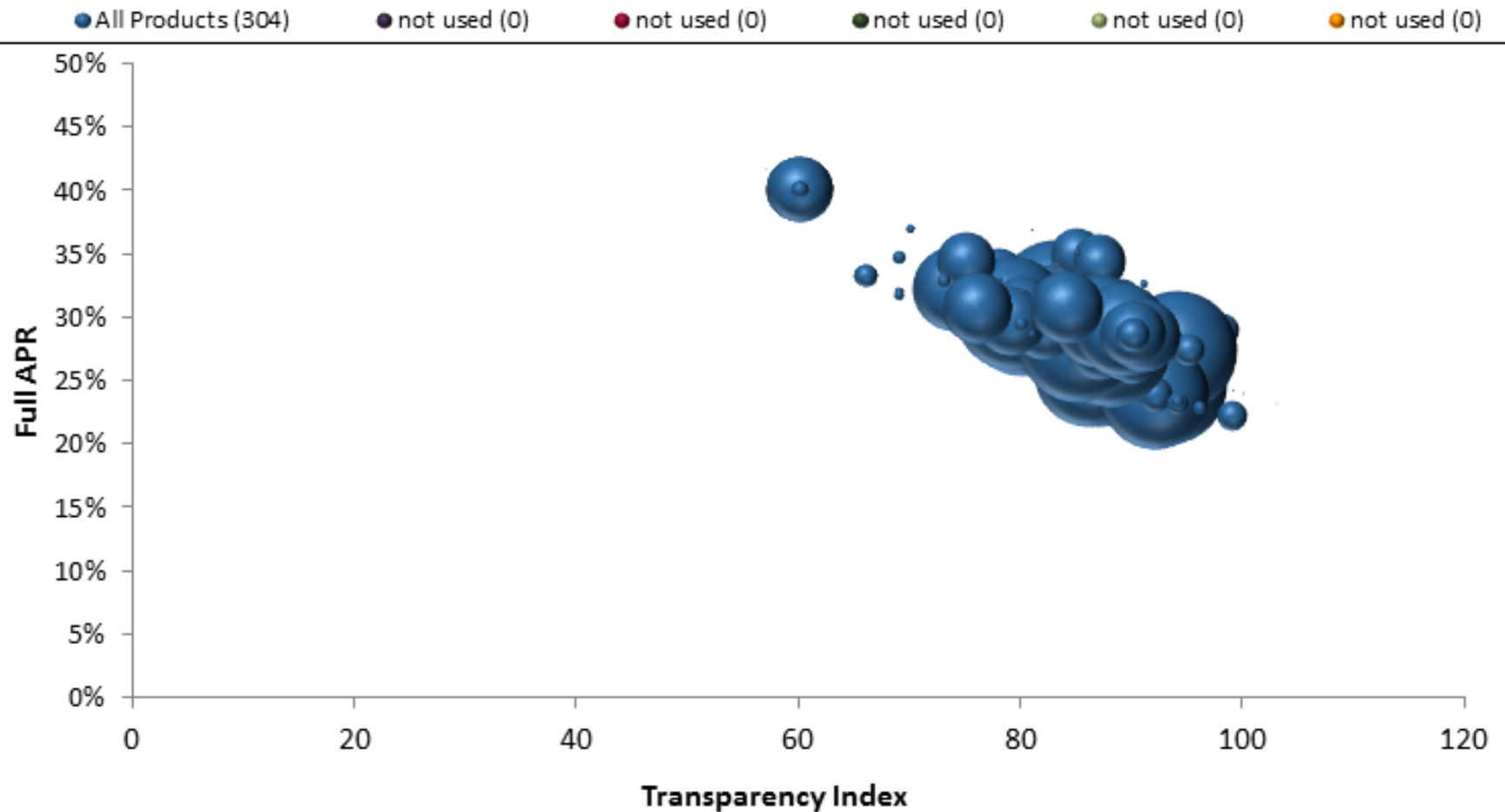
Country: Tanzania, Date: 26-Jul-2013



Full APR compared to Transparency Index

Country: India, Date: 05-Sep-2013

clients



Filtered for: Max Transp Index <35,000, Prices < 80%, Clients >50, Total Data Points: 304

Price Components, Uganda	Products		Clients	
Totals for this data analysis	67		418,185	
Interest Method				
Declining Balance	19	<div><div></div></div> 28%	144,223	<div><div></div></div> 34%
Flat	48	<div><div></div></div> 72%	273,962	<div><div></div></div> 66%
Interest Rate				
Same rate for all loans for the product	53	<div><div></div></div> 79%	247,709	<div><div></div></div> 59%
Different rates for different loans	14	<div><div></div></div> 21%	170,476	<div><div></div></div> 41%
Fees				
No fees charged	1	<div><div></div></div> 1%	6,528	<div><div></div></div> 2%
1 Fee charged	26	<div><div></div></div> 39%	196,909	<div><div></div></div> 47%
2 Fees charged	27	<div><div></div></div> 40%	158,914	<div><div></div></div> 38%
3 or more fees charged	13	<div><div></div></div> 19%	55,834	<div><div></div></div> 13%
Insurance				
No Insurance required	8	<div><div></div></div> 12%	39,740	<div><div></div></div> 10%
1 Insurance required	59	<div><div></div></div> 88%	378,445	<div><div></div></div> 90%
2 or more insurance products required	0	<div><div></div></div> 0%	0	<div><div></div></div> 0%
Compulsory Deposit				
No Compulsory Deposit required	34	<div><div></div></div> 51%	168,688	<div><div></div></div> 40%
Upfront Compulsory Deposit only	27	<div><div></div></div> 40%	190,282	<div><div></div></div> 46%
Ongoing Compulsory Deposits only	0	<div><div></div></div> 0%	0	<div><div></div></div> 0%
Upfront & Ongoing Deposits required	6	<div><div></div></div> 9%	59,215	<div><div></div></div> 14%

Step 4: The Reason Behind the Price Curve

Why is there a price curve?

Because there is a delivery cost curve!

Cost Components that Affect Pricing

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

Realizing that there is a cost curve

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

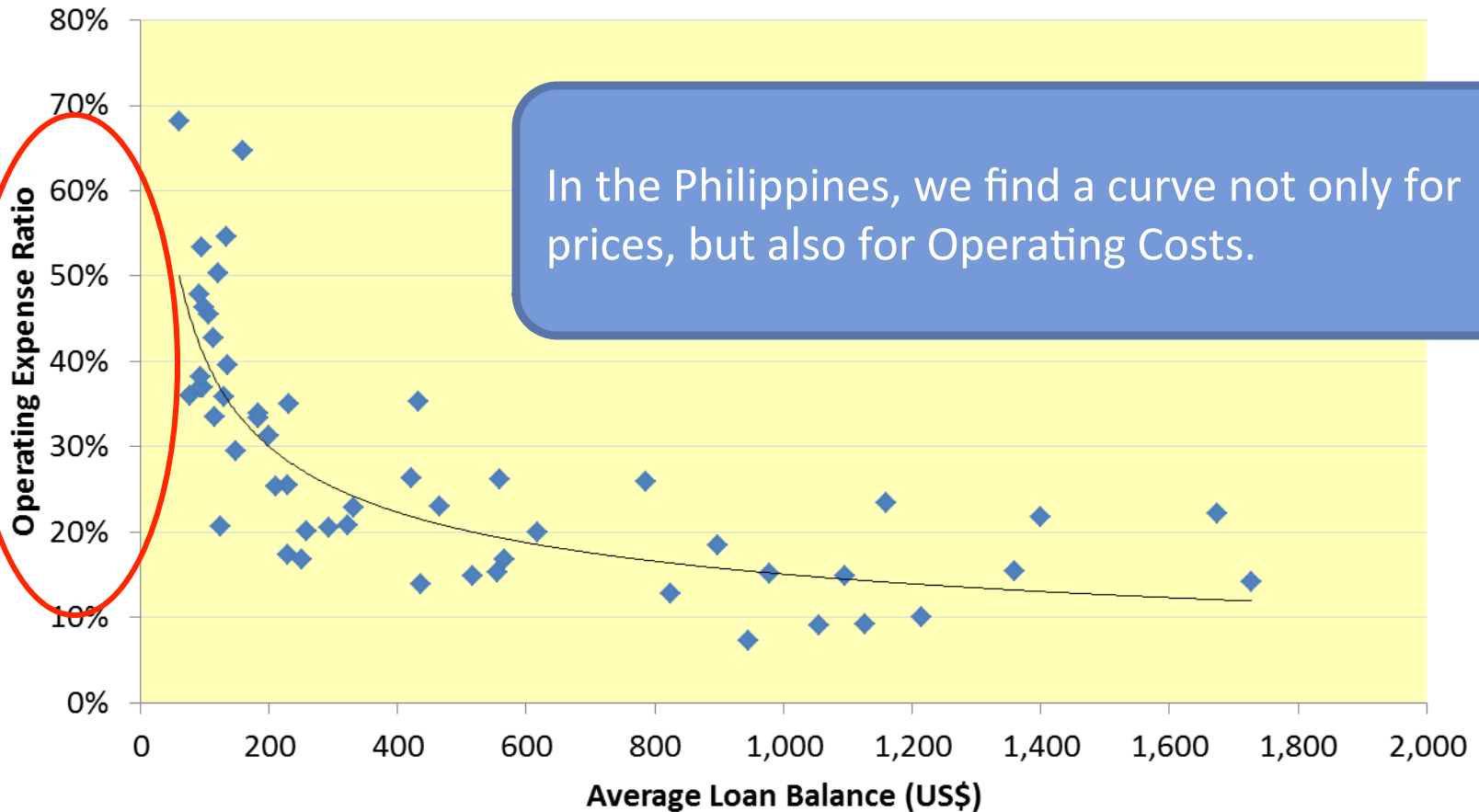
Realizing that there is a cost curve

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

Realizing that there is a cost curve

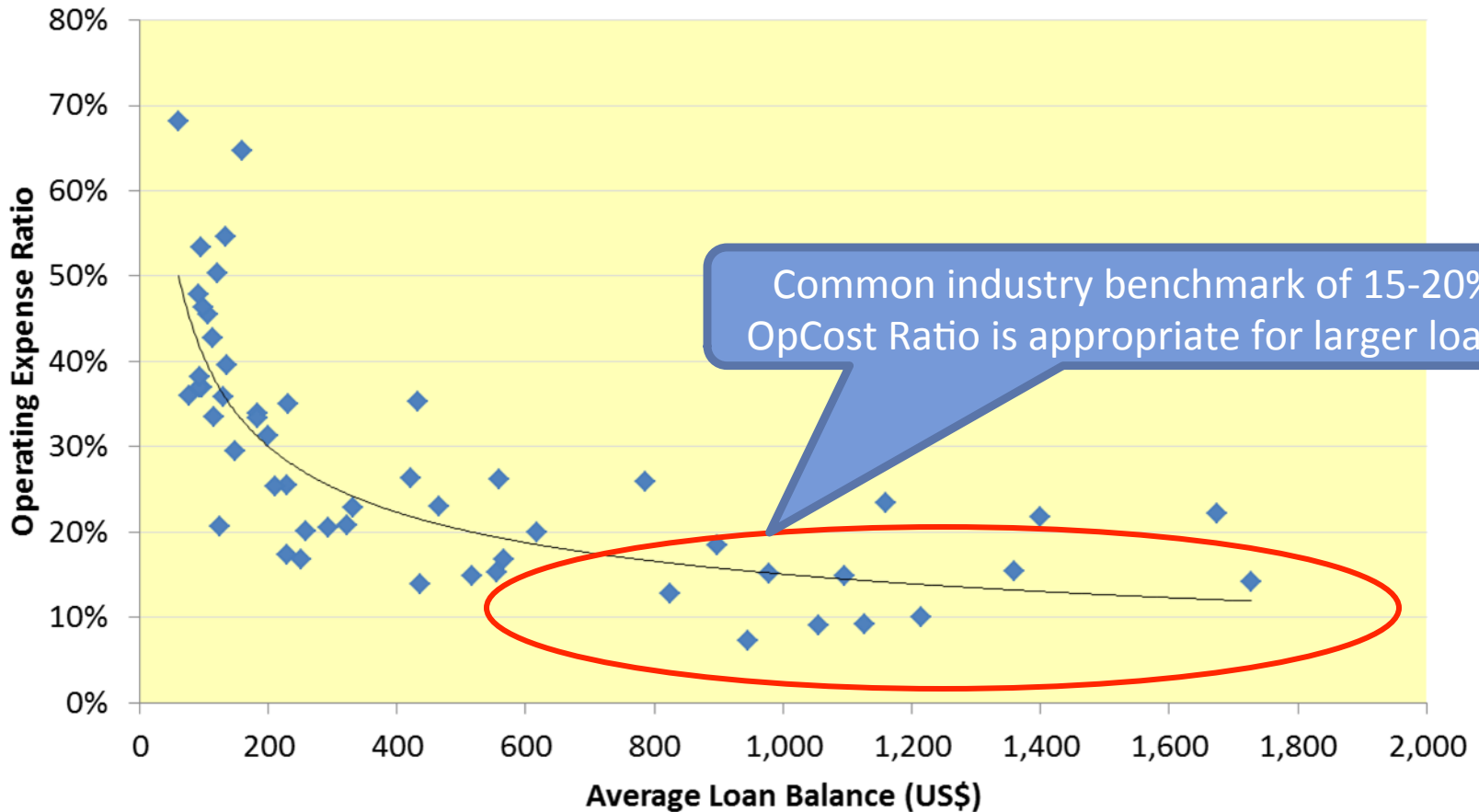
Efficiency	1	2	3
Operating Cost per Loan	\$50	\$50	\$30
Loan Size	\$500	\$250	\$100
Operating Cost Ratio	10%	20%	30%

Operating Expense Ratio vs Average Loan Balance Philippines, 59 MFIs



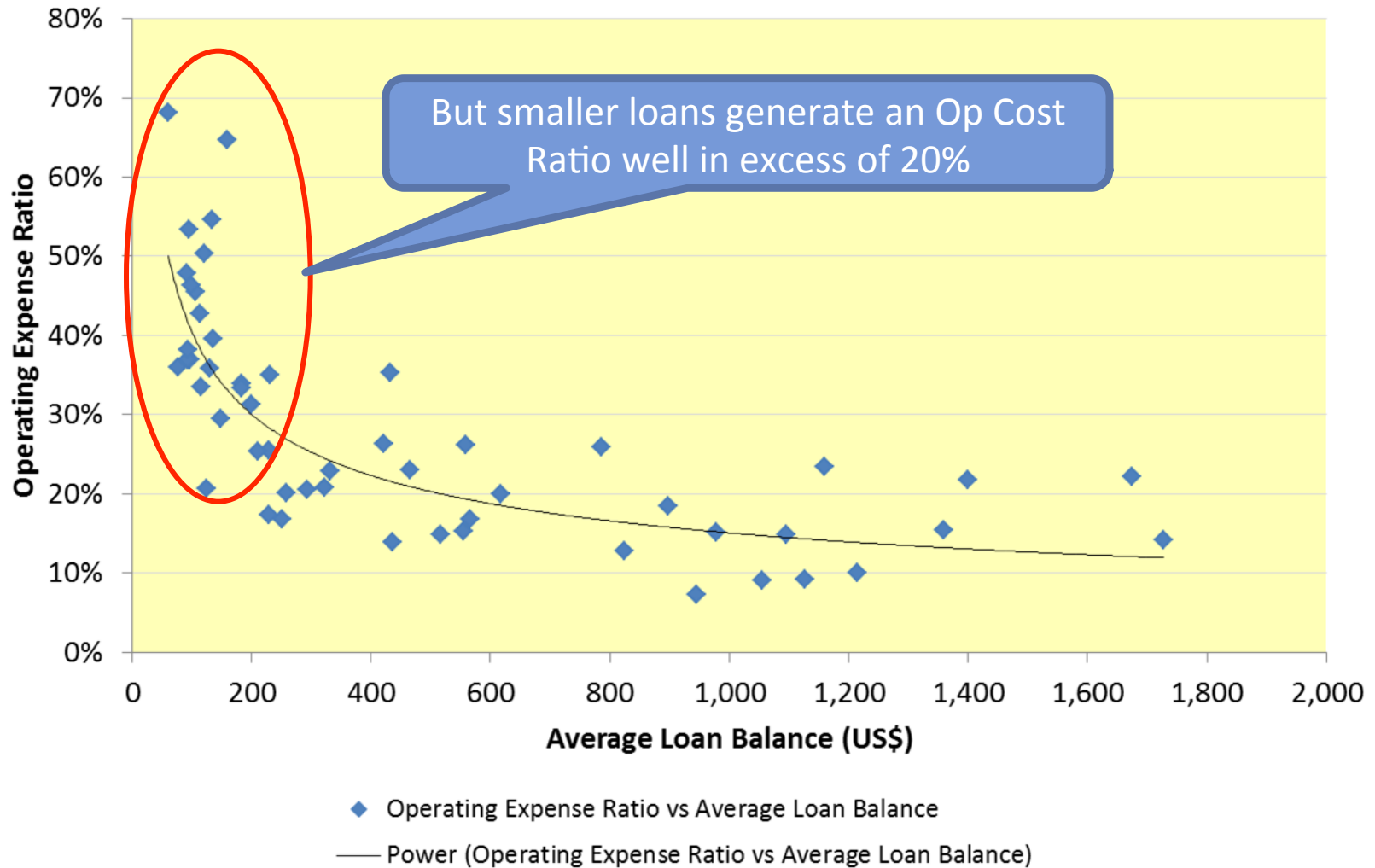
- ◆ Operating Expense Ratio vs Average Loan Balance
- Power (Operating Expense Ratio vs Average Loan Balance)

Operating Expense Ratio vs Average Loan Balance Philippines, 59 MFIs

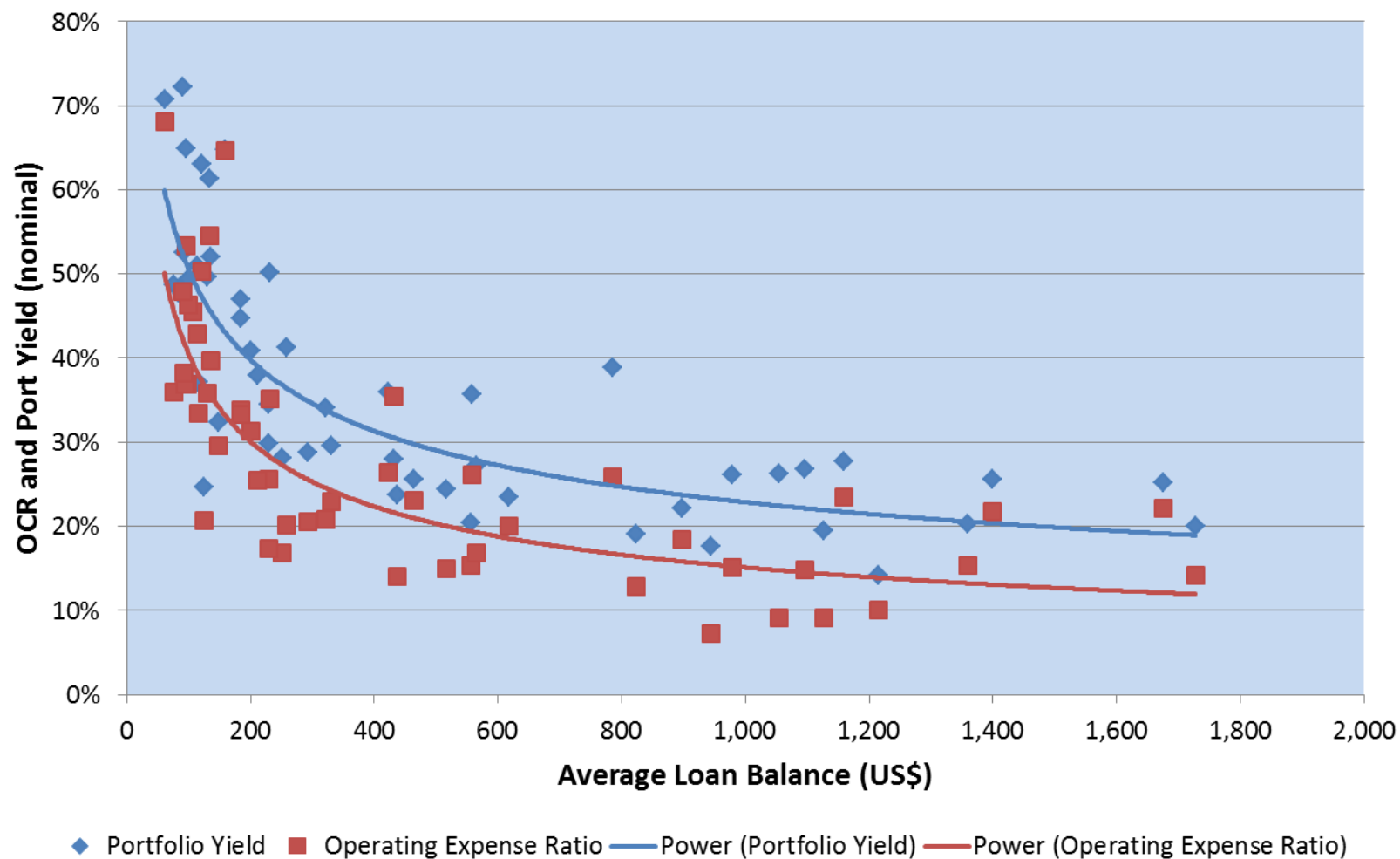


◆ Operating Expense Ratio vs Average Loan Balance
— Power (Operating Expense Ratio vs Average Loan Balance)

Operating Expense Ratio vs Average Loan Balance Philippines, 59 MFIs



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

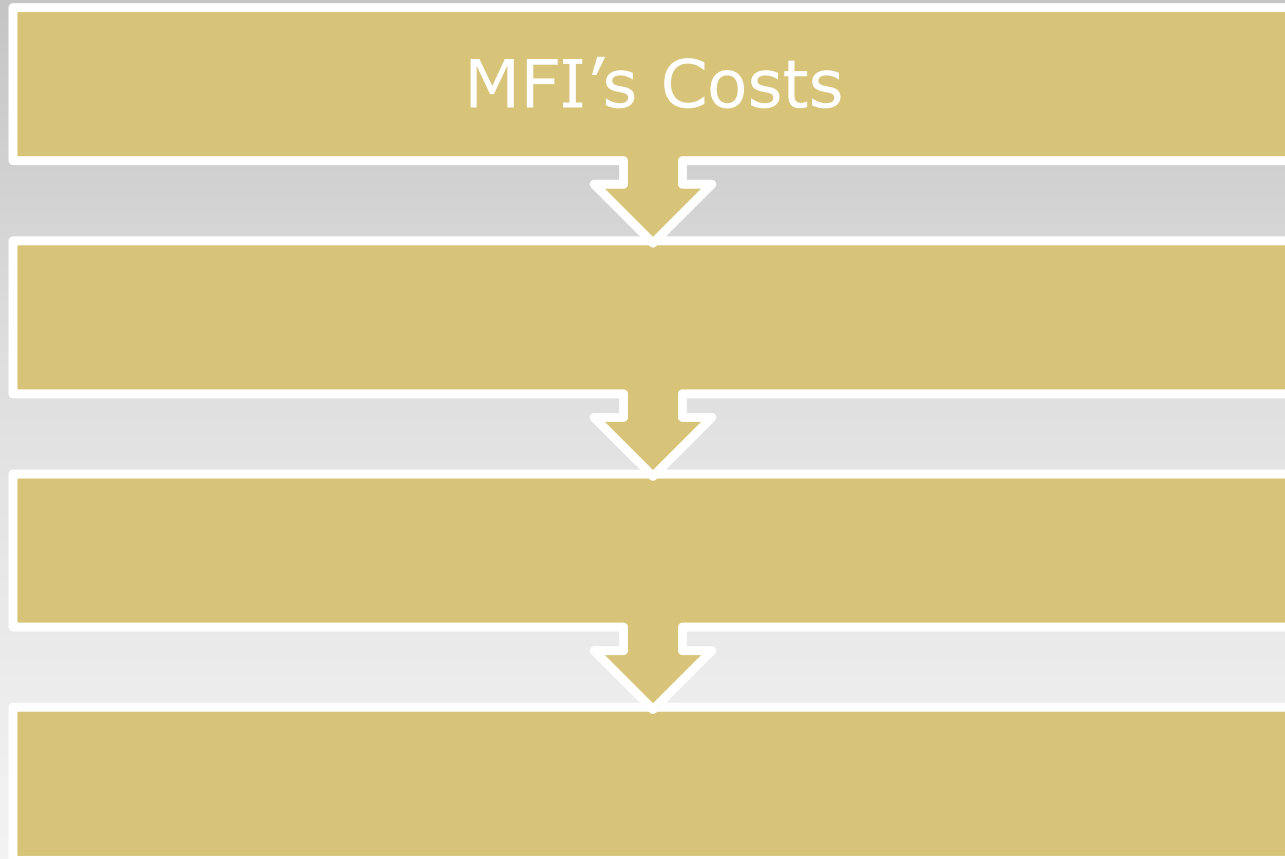


Step 5: From Transparent to Responsible

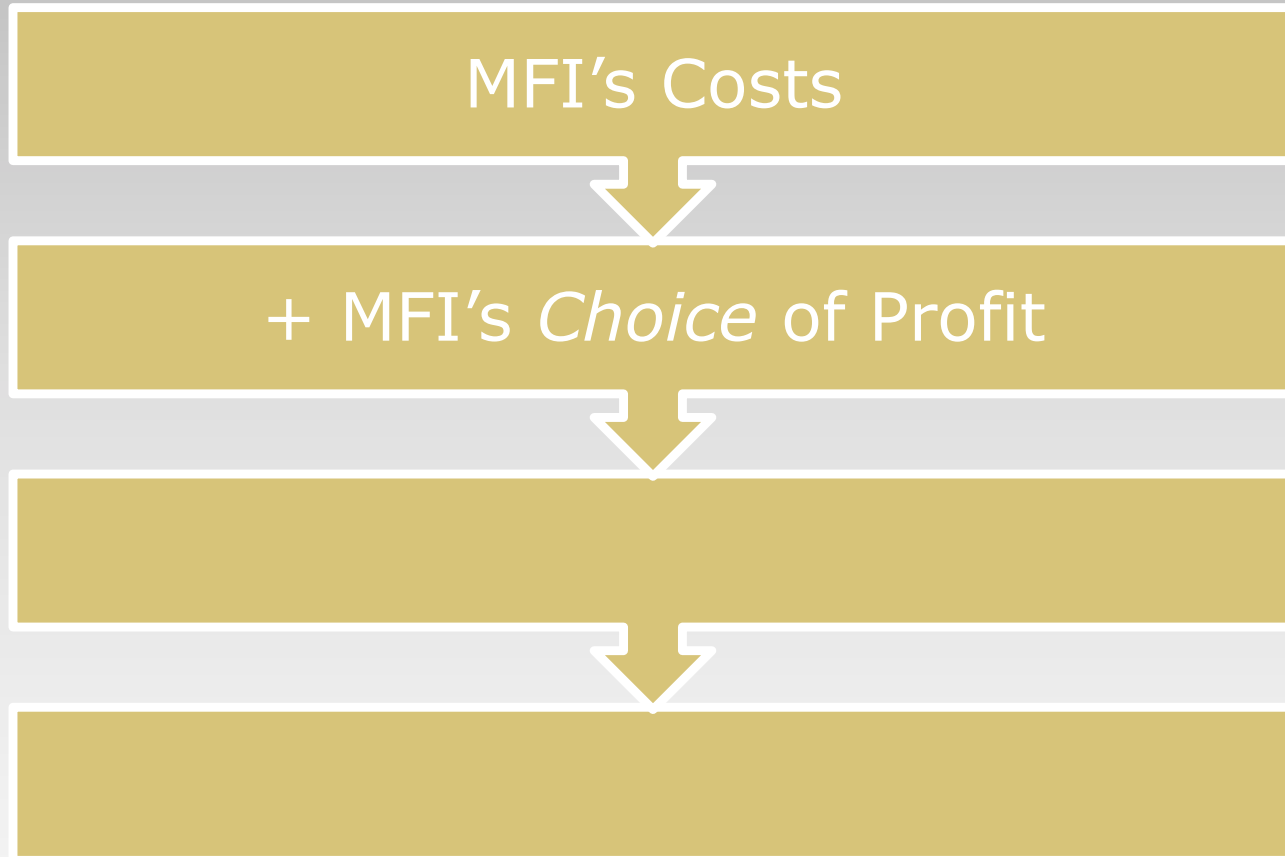
**The industry is advocating
“Responsible Practice”**

**What does this mean for pricing? Prices
and Profits go hand-in-hand and are both
decisions of management**

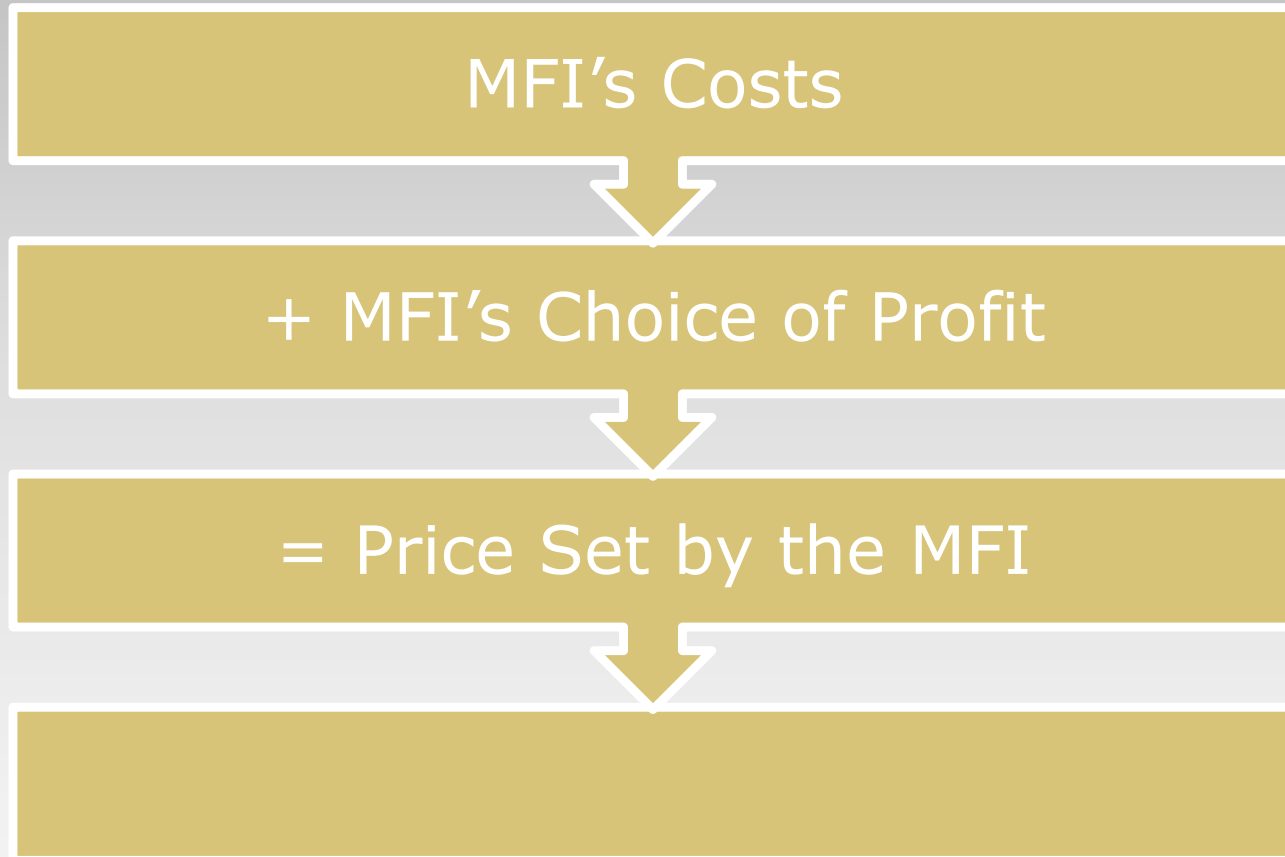
Defining a Responsible Price



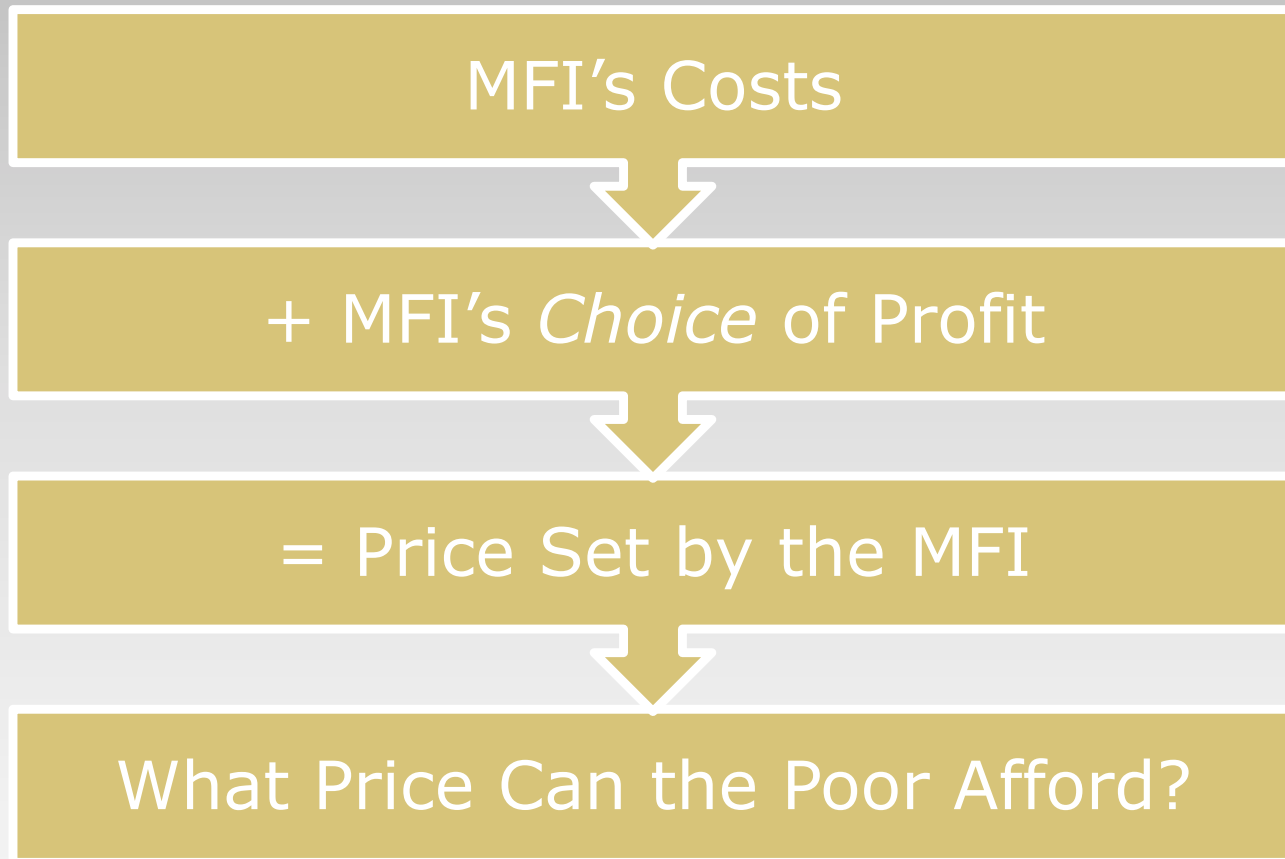
Defining a Responsible Price



Defining a Responsible Price



Defining a Responsible Price



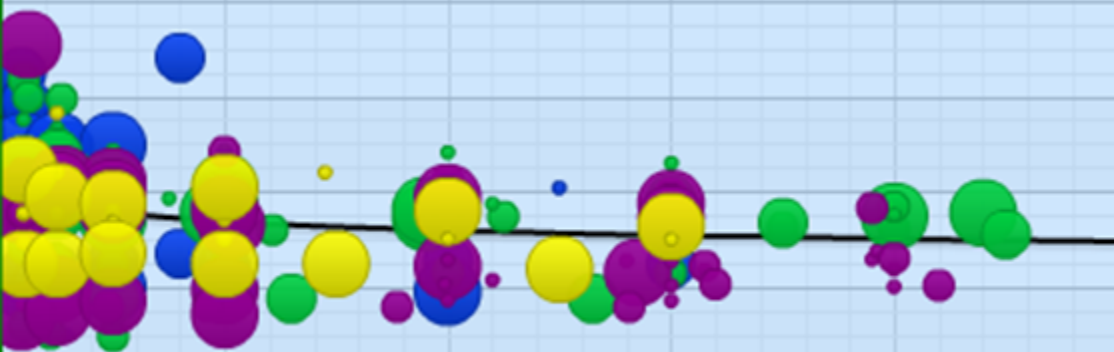
Innovations and Mission Drift

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.**



Promoting Transparent Pricing in the Microfinance Industry

MicroFinance Transparency is an NGO registered in the USA



Product Size vs Interest Rate (Zambia)

