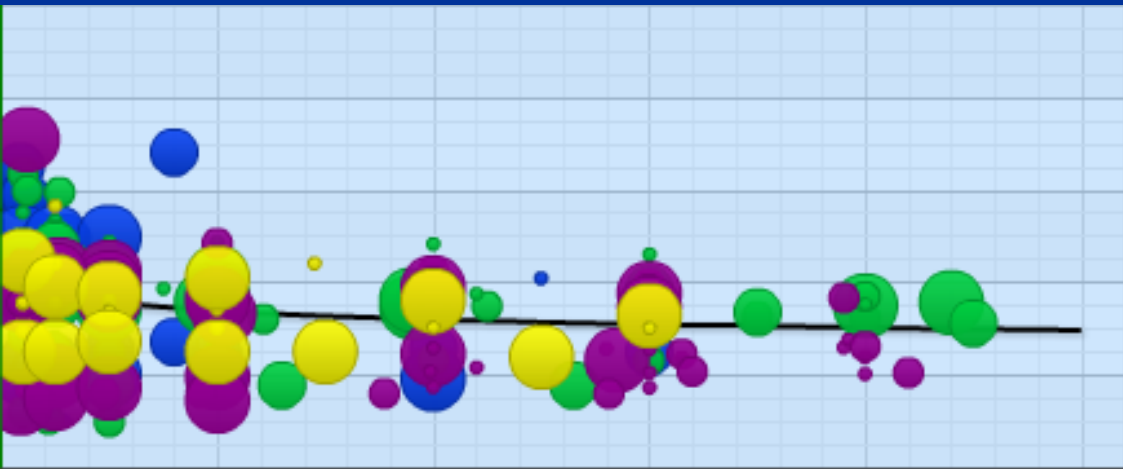


Transparent Pricing and the Microloan Price Curve

**UNCITRAL
Vienna**

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MicroFinance Transparency
January 2013





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AGENDA

- 1: What is a “transparent price”?
- 2: Curves, not averages!
- 3: The cost curve drives the price curve
- 4: Profits come from being “off of the curve”

SECTION 1:

What is a “transparent price”?

What price DO we charge?

How should we DEFINE price?

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%
“Savings”:	0%	0%	20%	0%
TCC	\$50	\$50	\$33	\$42
APR	49%	47%	49%	40%

The Downward Spiral

1. How did prices get so confusing and non-transparent?
2. It is a combination of:
 1. Lack of transparent pricing regulation
 2. 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:
 1. Interest: 2.5% decl.

2. MFI 2:
 1. Interest: 3.0% decl.

The Downward Spiral

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

1. MFI 1:
 1. Interest: 2.5% decl.
2. MFI 2:
 1. 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:
 1. Interest: **1.75% flat**
2. MFI 2:
 1. 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:
 1. Interest: 1.75% flat
2. MFI 2:
 1. 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:
 1. Interest: 1.75% flat
2. MFI 2:
 1. 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:
 1. Interest: 1.75% flat
 2. **APR: 37%**
2. MFI 2:
 1. Interest: 1.6% flat, 2% upfront fee
 2. **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:
 1. Interest: 1.75% flat
 2. APR: 37%
 3. **ROE: 10%**
2. MFI 2:
 1. Interest: 1.6% flat, 2% upfront fee
 2. APR: 57%
 3. **ROE: 40%**

The Downward Spiral

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

Prices and Profits

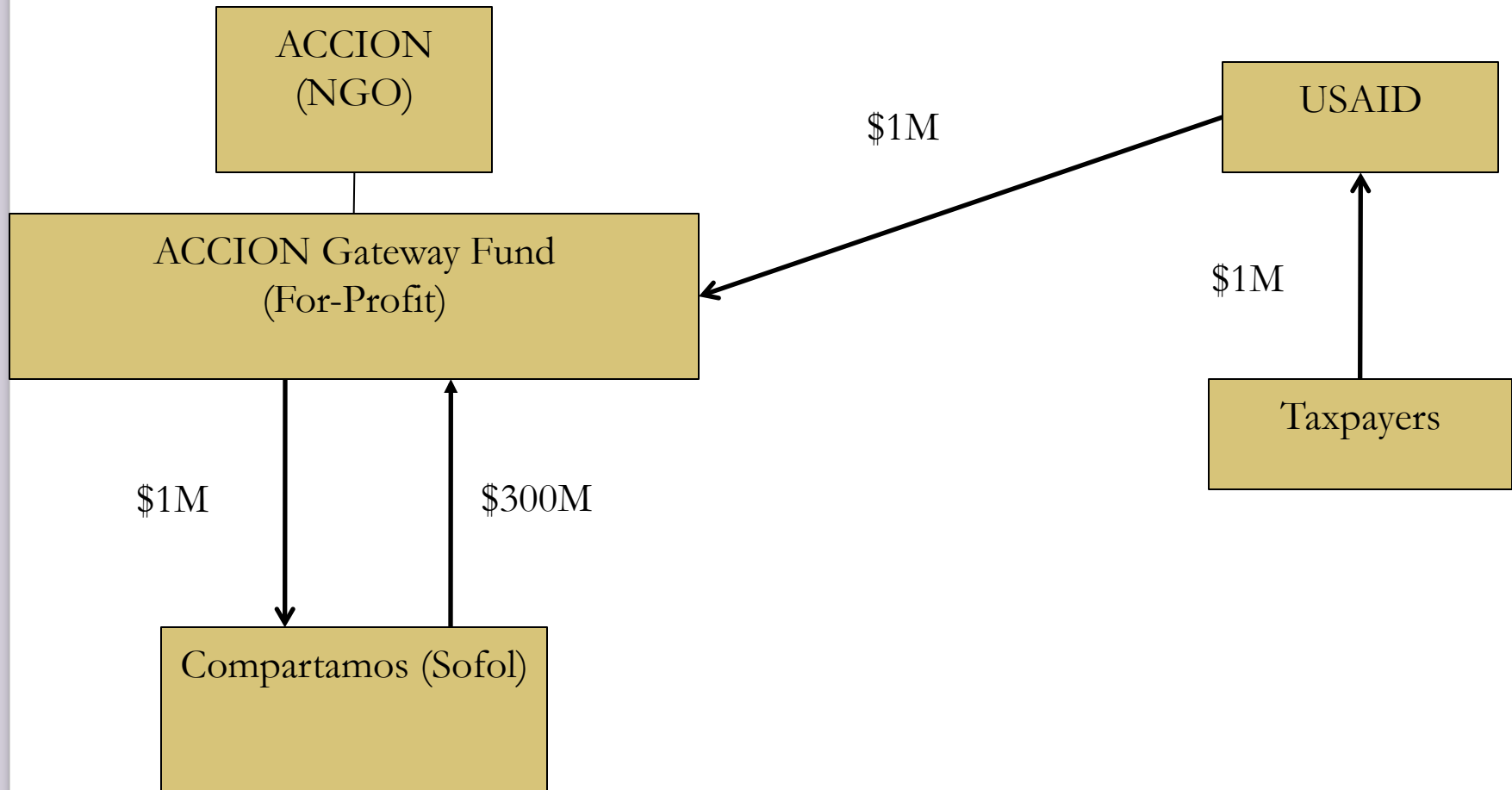
Compartamos (Mexico)

The Price	APR	EIR
w/o Collateral Deposit	105%	182%
With Collateral Deposit	126%	227%

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%

ACCION's Investment in Compartamos



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
Total	\$287M

“Should we use TCC with clients?”

(Total Cost of Credit)

- **No!! TCC only works for exactly identical products**
 - TCC is flawed even for products that seem very similar.
 - TCC is deceptive for comparing dissimilar products
- **Why?**
 - A client doesn't *buy* a loan.
 - A client *rents* a variable amount of money for a variable amount of time.
 - We shouldn't use a “purchase price”, we need to use a “rental price”

What is the APR?

(Annual Percentage Rate, using nominal annualization)

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 costs should we include?”

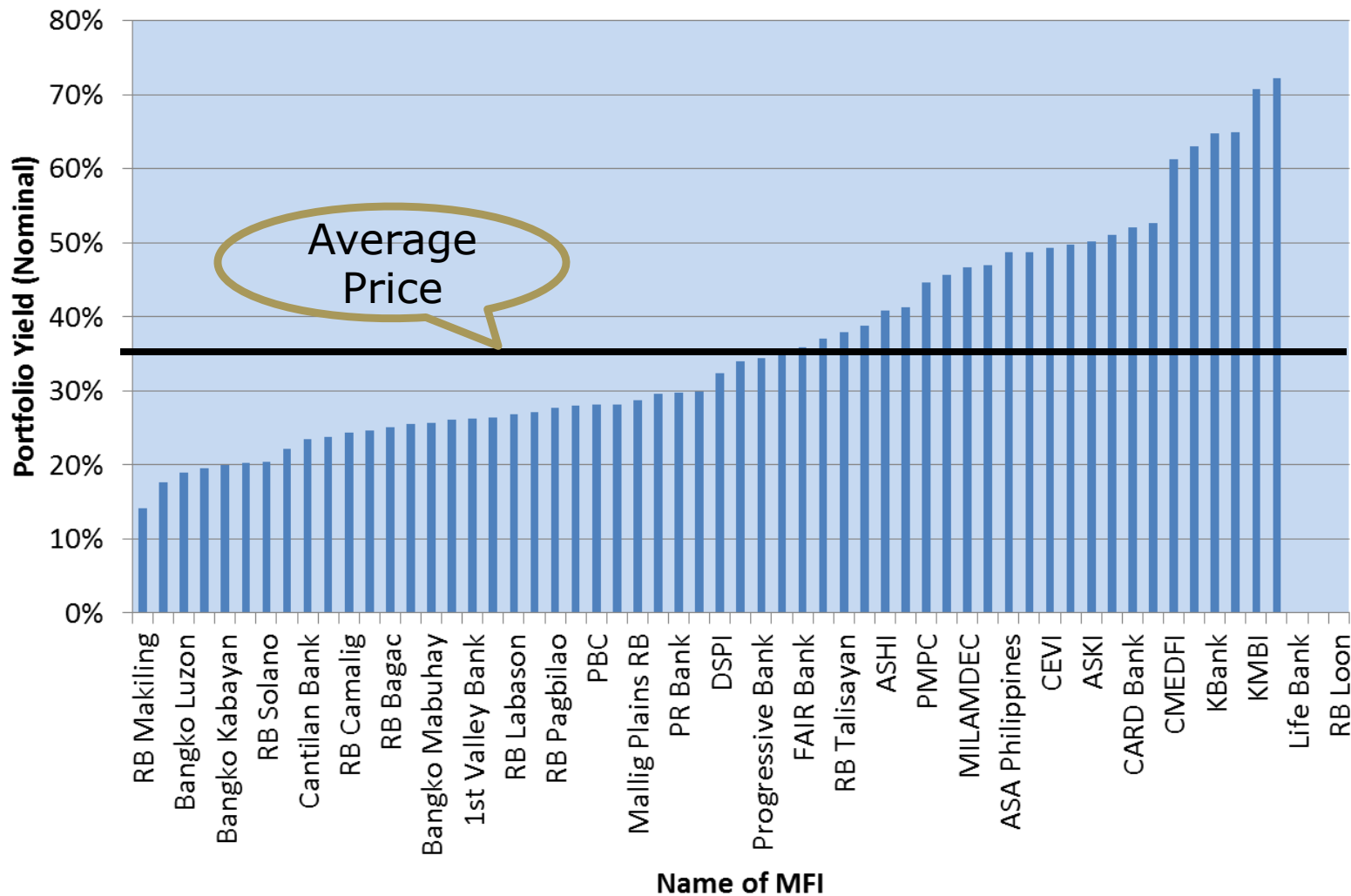
- **Interest:** Certainly!
- What else? Everything that is a ***compulsory requirement*** for receiving the loan.
- **Fees:** Any compulsory fees must be included
 - **Training** fees? Yes, if the training is a requirement for the loan. The full-price is then for “credit-plus-training”
 - **Insurance** fees? Yes, if insurance is a requirement. The client can then compare: “Loan-only for 34% APR, loan-and-insurance for 38% APR”
 - **Security Deposits** (“Savings”): Yes! This is *not* savings!

SECTION 2:

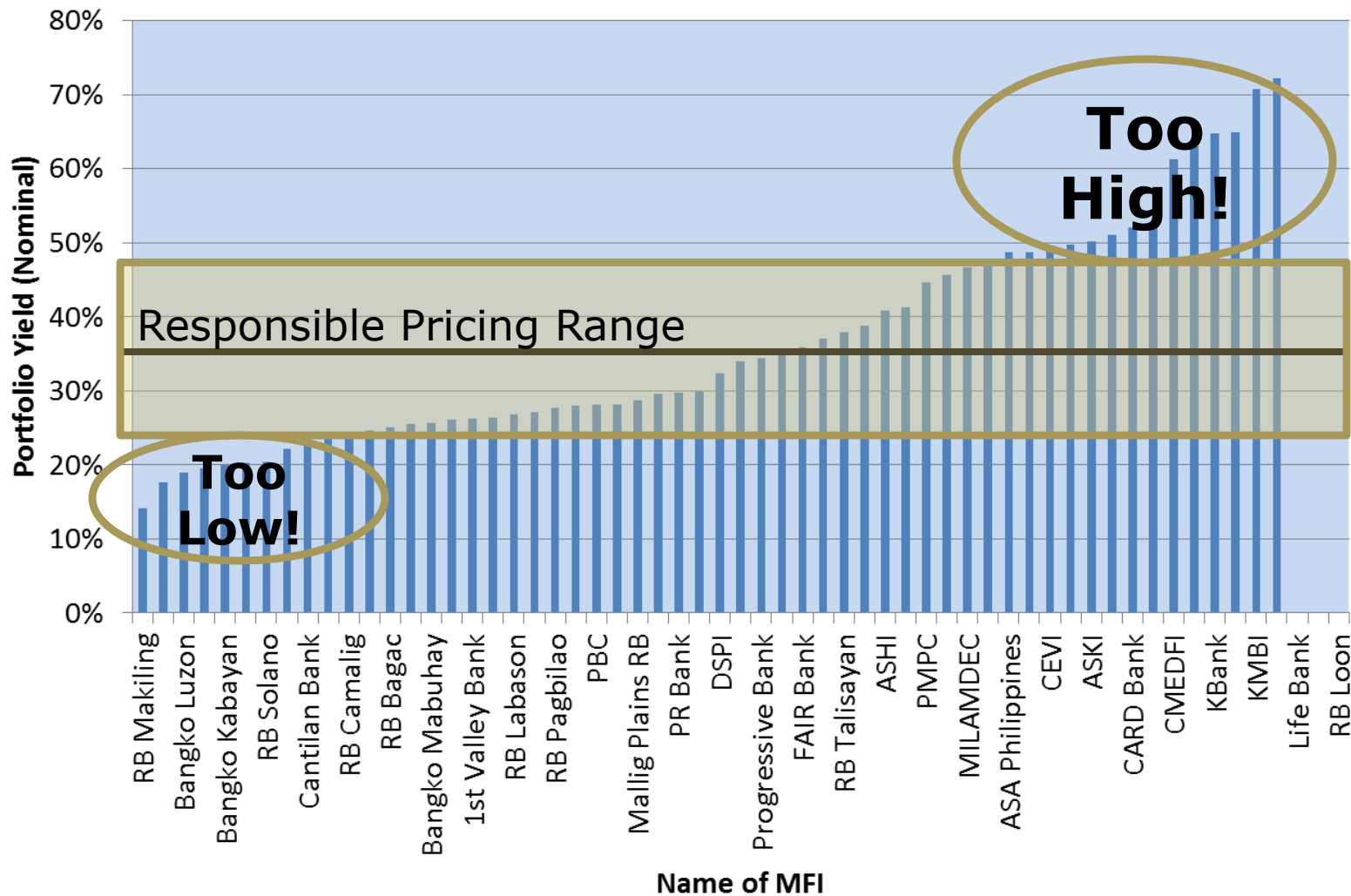
Cardinal Rule in analyzing micro-loans:

Never use averages

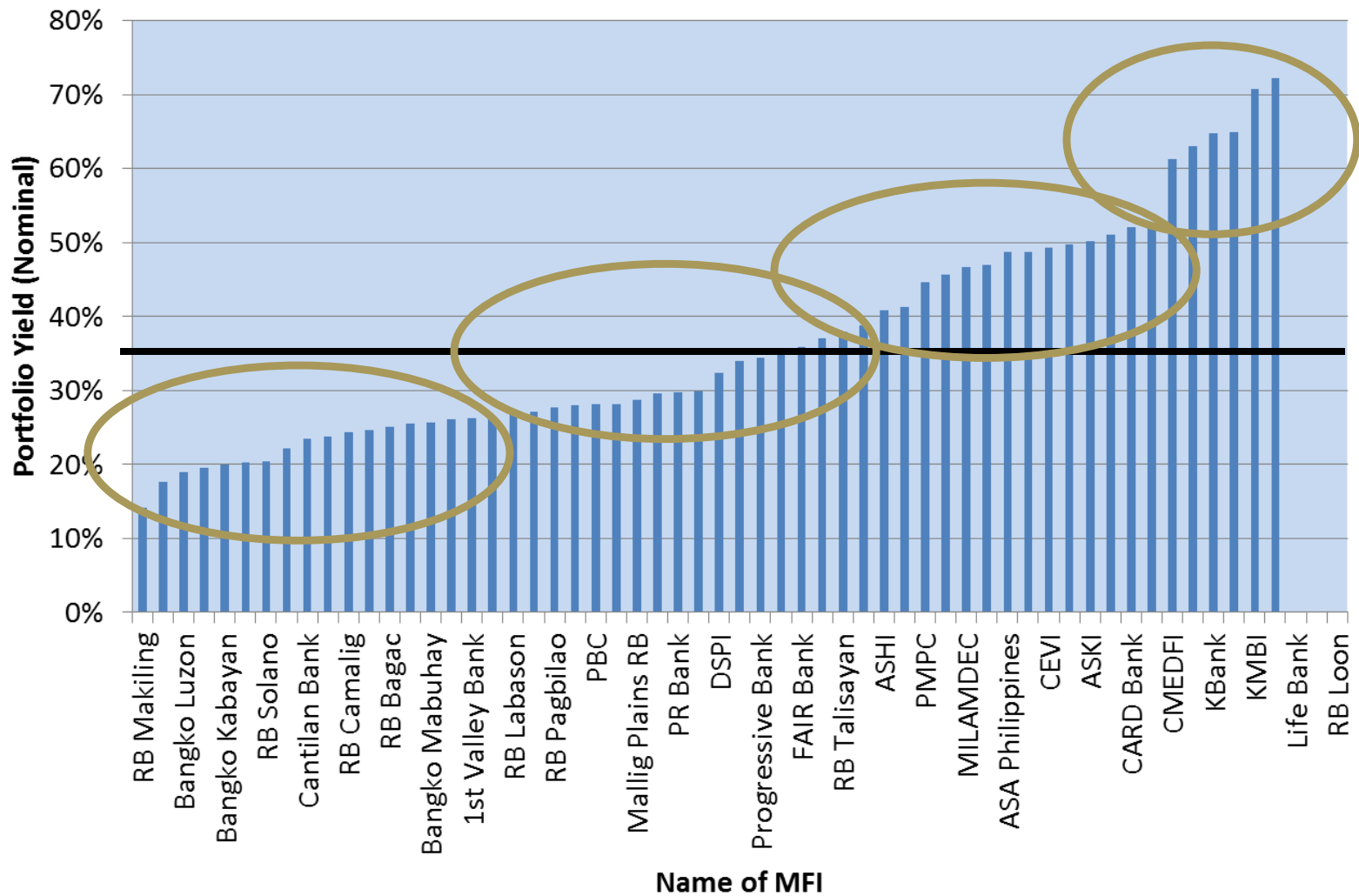
Portfolio Yield by MFI Philippines, 59 MFIs



Portfolio Yield by MFI Philippines, 59 MFIs

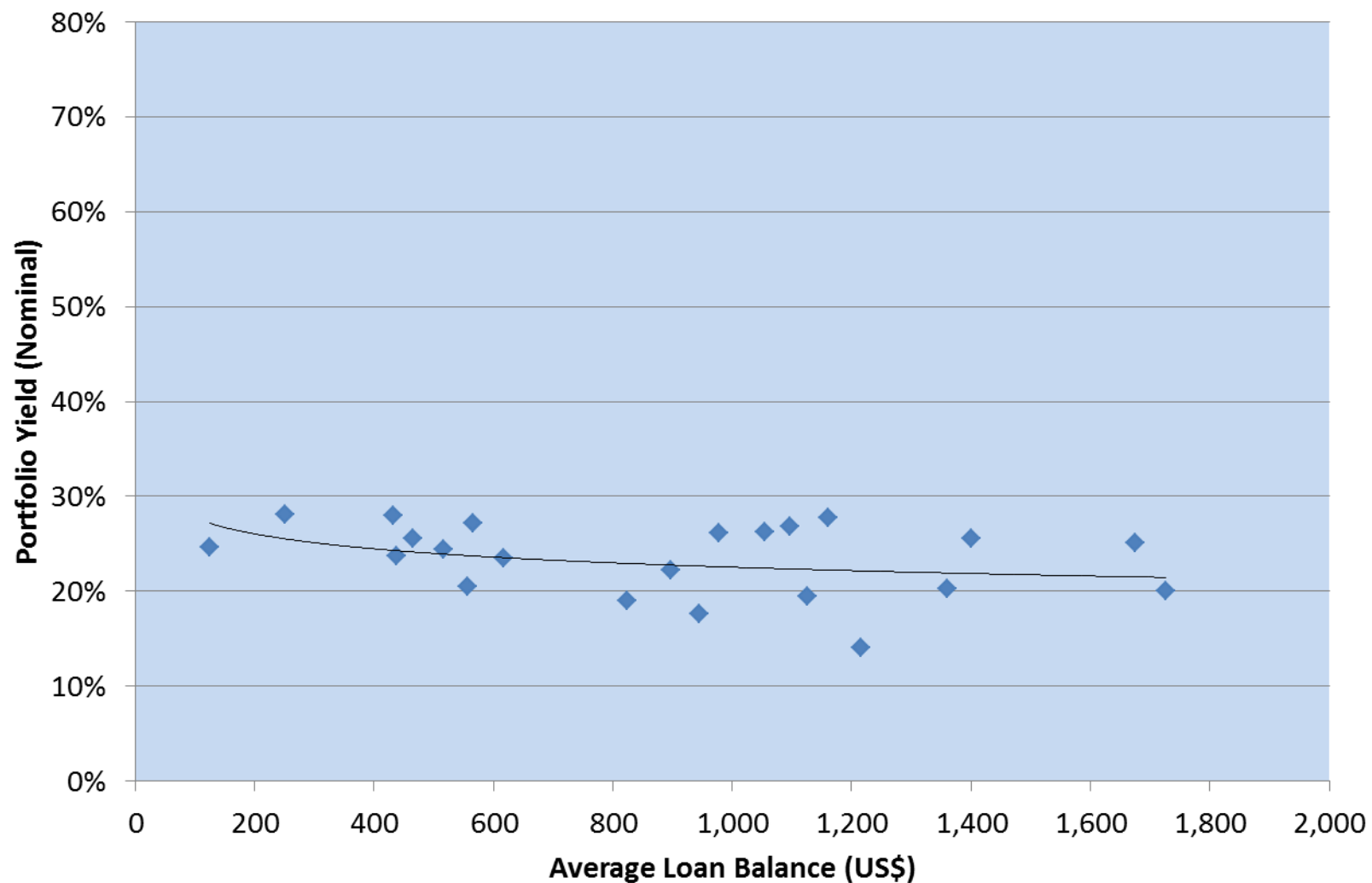


Portfolio Yield by MFI Philippines, 59 MFIs



Portfolio Yield vs Average Loan Balance

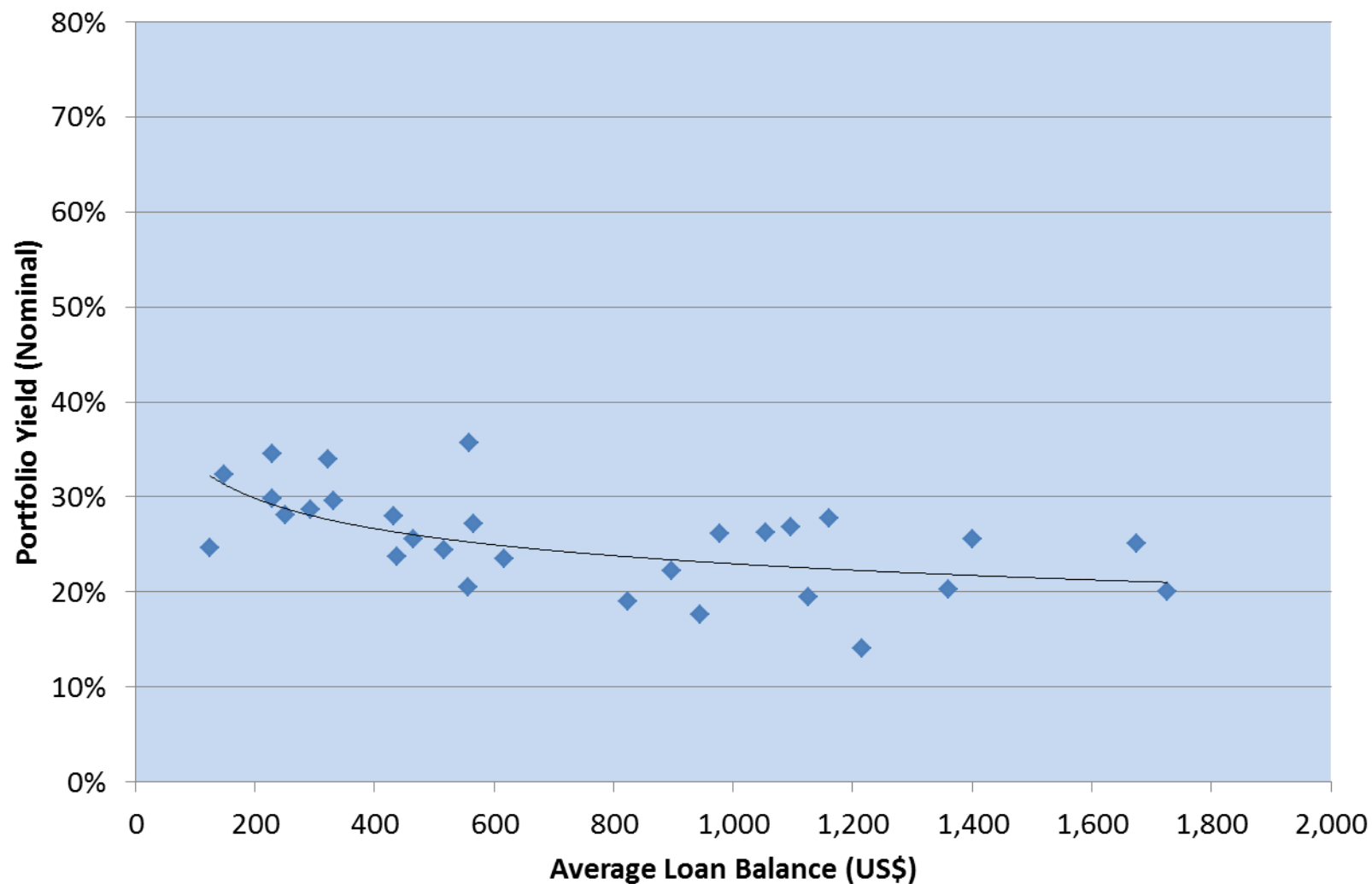
Philippines, 24 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

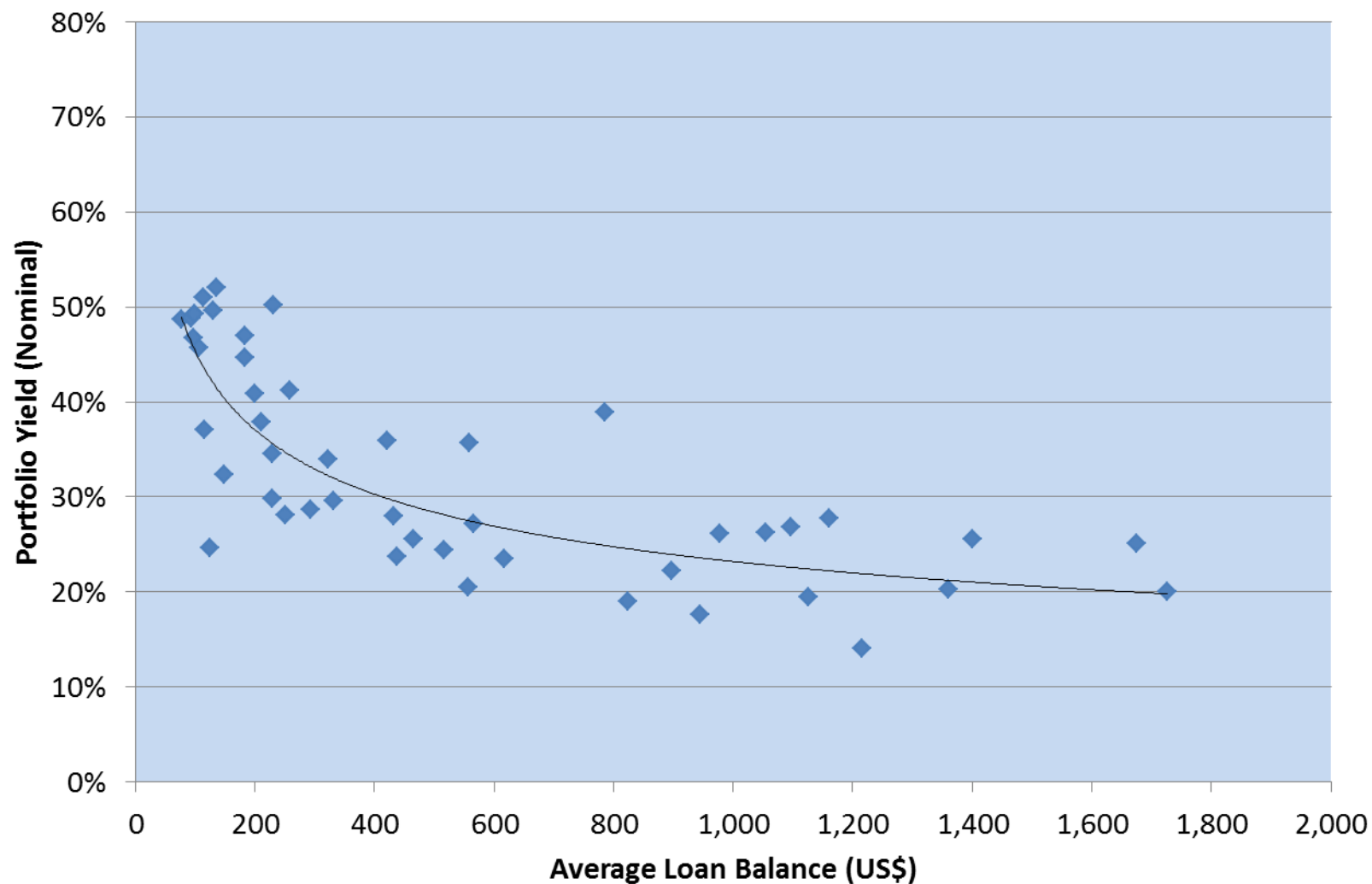
Portfolio Yield vs Average Loan Balance Philippines, 32 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

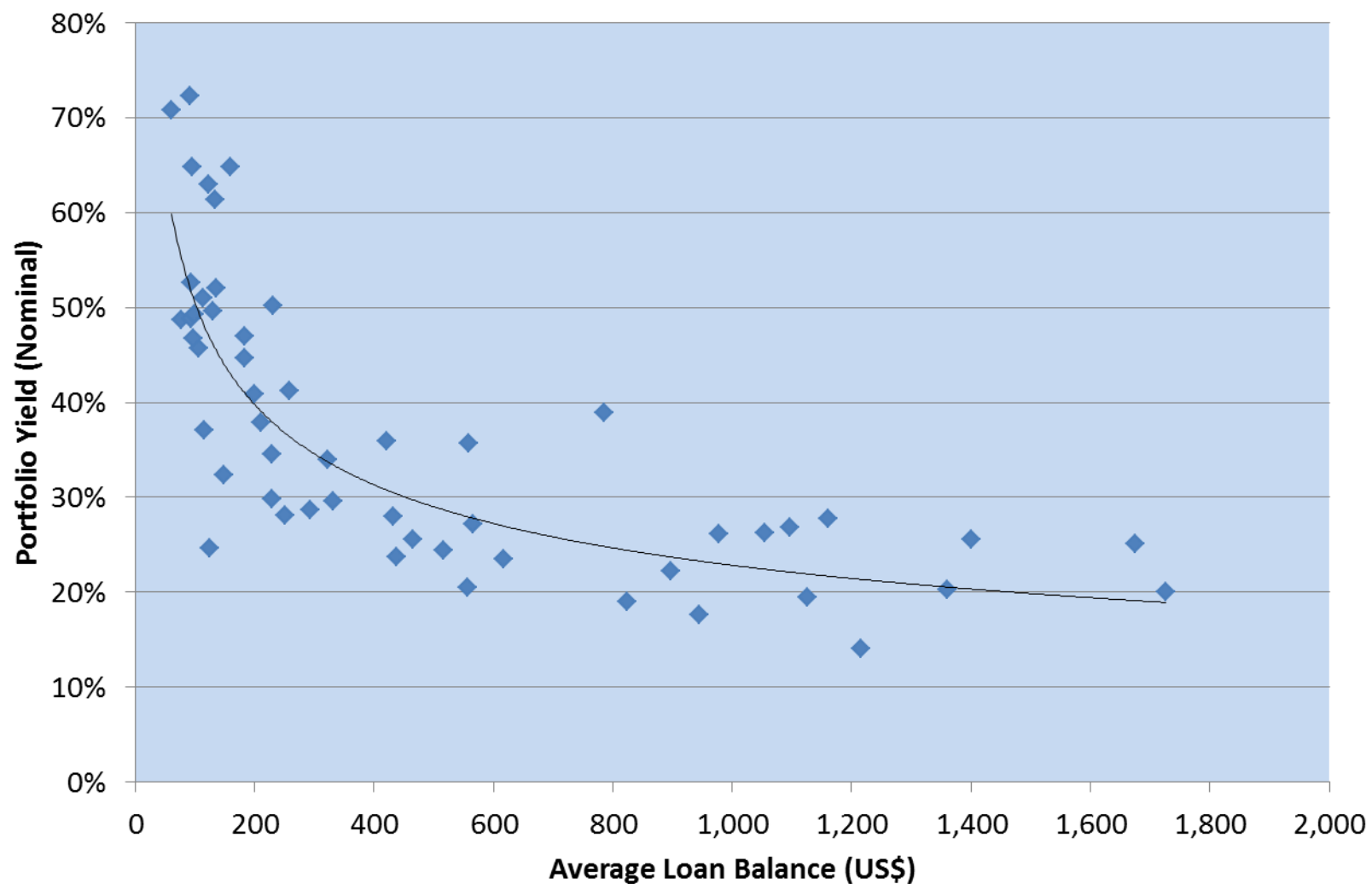
Portfolio Yield vs Average Loan Balance Philippines, 49 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

Portfolio Yield vs Average Loan Balance Philippines, 59 MFIs



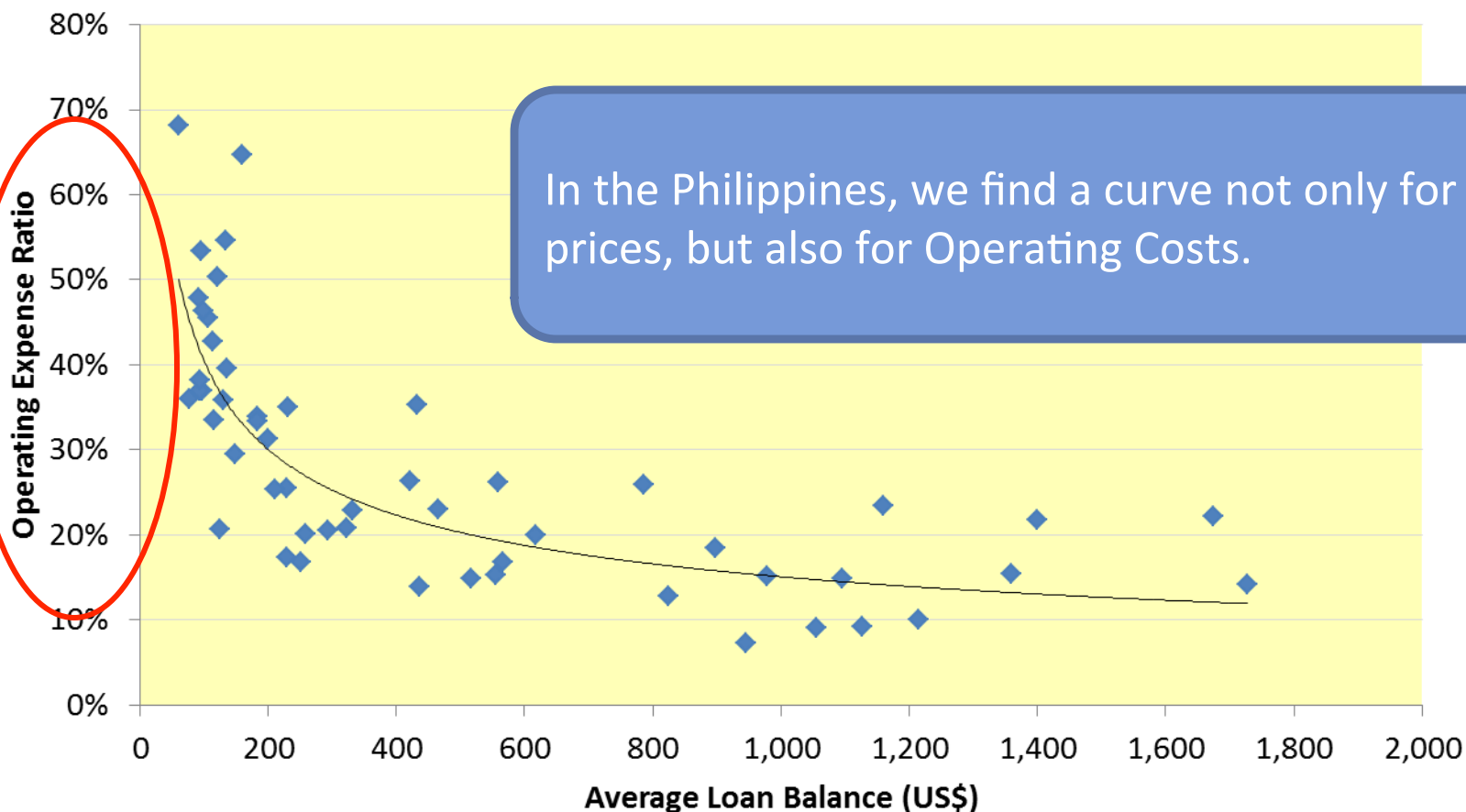
◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

SECTION 3:

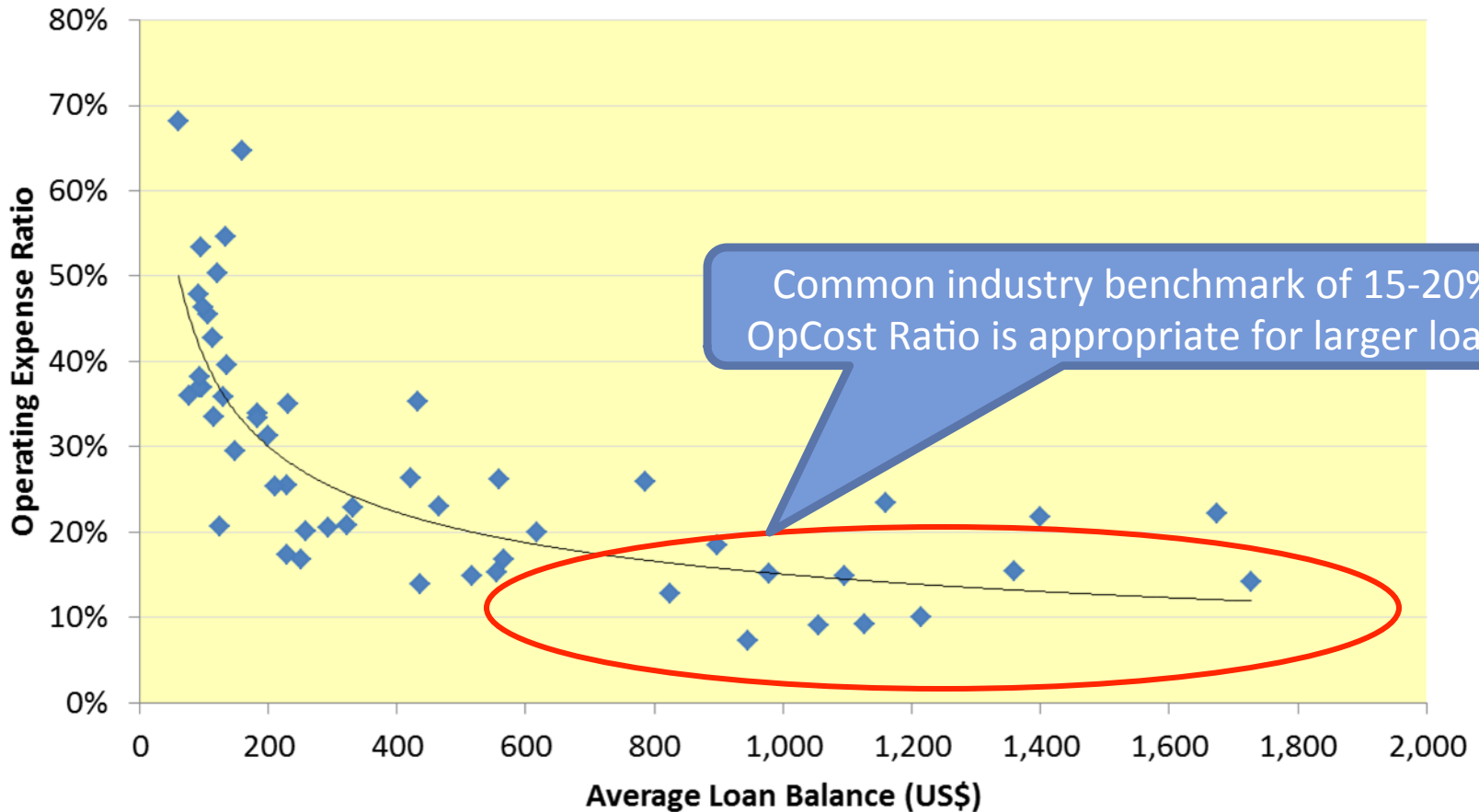
**Why is there a price curve for
micro-loans?**

Operating Expense Ratio vs Average Loan Balance Philippines, 59 MFIs



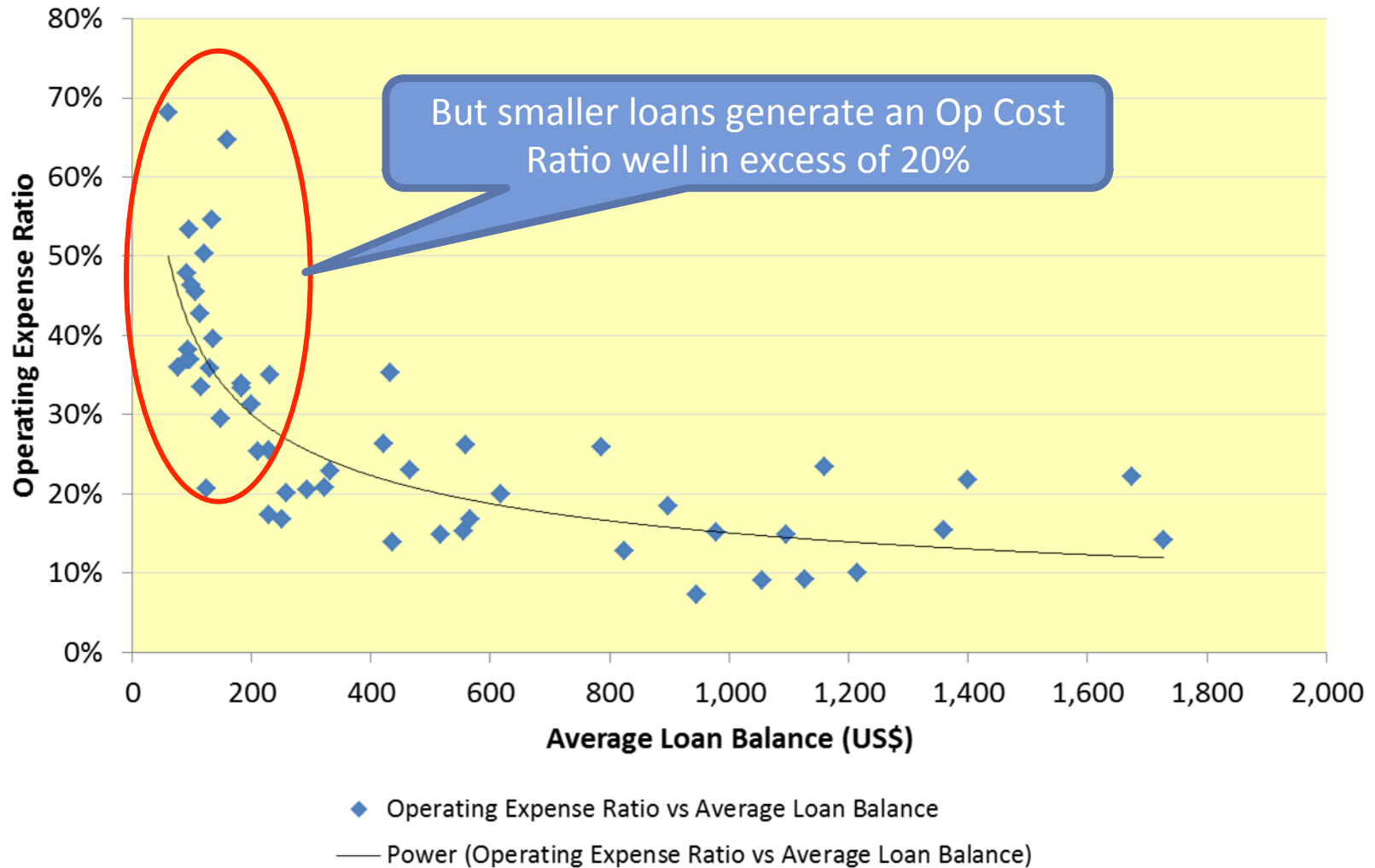
- ◆ Operating Expense Ratio vs Average Loan Balance
- Power (Operating Expense Ratio vs Average Loan Balance)

Operating Expense Ratio vs Average Loan Balance Philippines, 59 MFIs

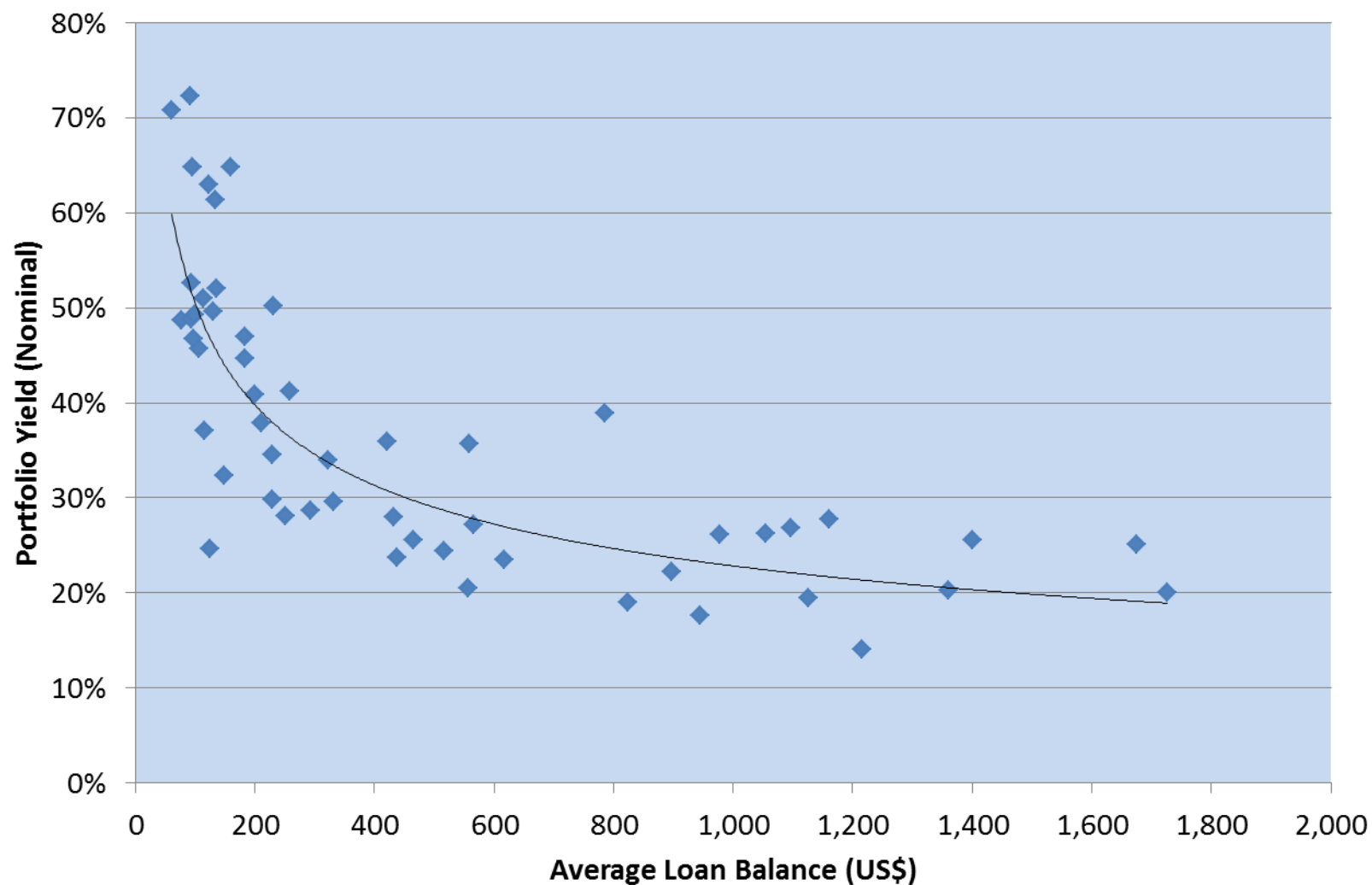


◆ Operating Expense Ratio vs Average Loan Balance
— Power (Operating Expense Ratio vs Average Loan Balance)

Operating Expense Ratio vs Average Loan Balance Philippines, 59 MFIs



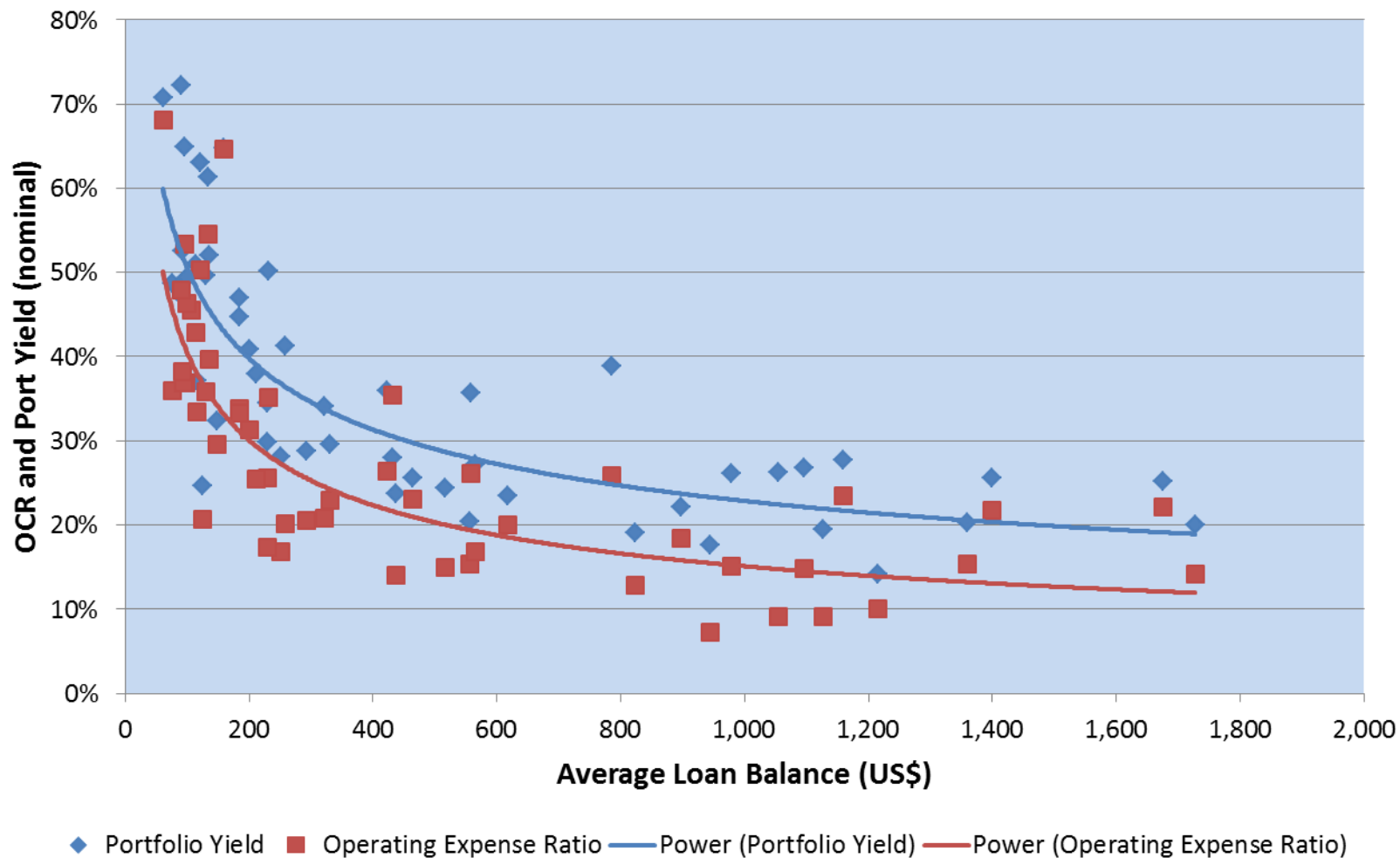
Portfolio Yield vs Average Loan Balance Philippines, 59 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

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



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

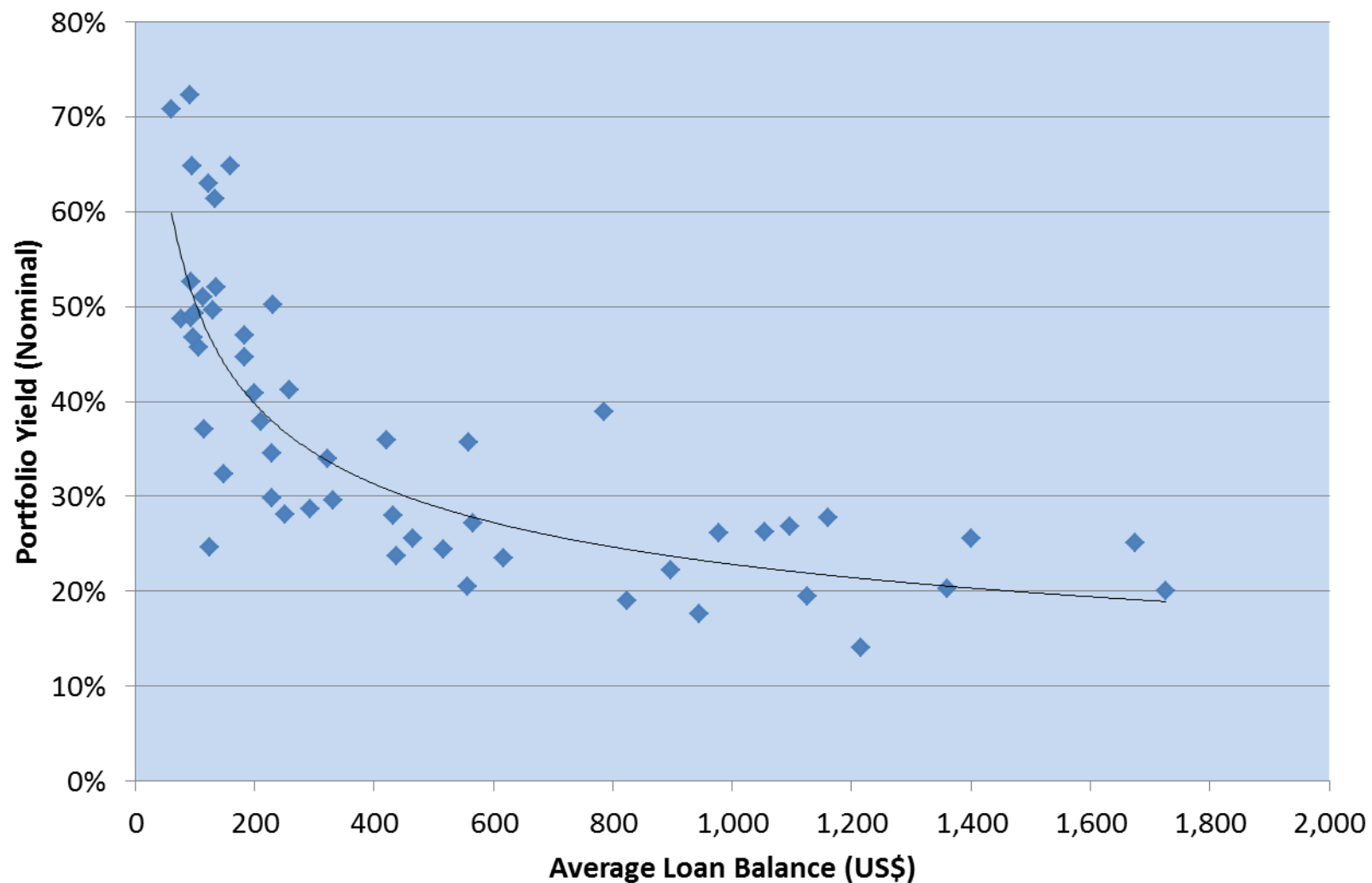
Efficiency	1	2	3
Operating Cost per Loan	\$50	\$50	\$30
Loan Size	\$500	\$250	\$100
Operating Cost Ratio	10%	20%	30%

SECTION 4:

Prices and Profits

**Profits are higher when prices are
“off the curve”**

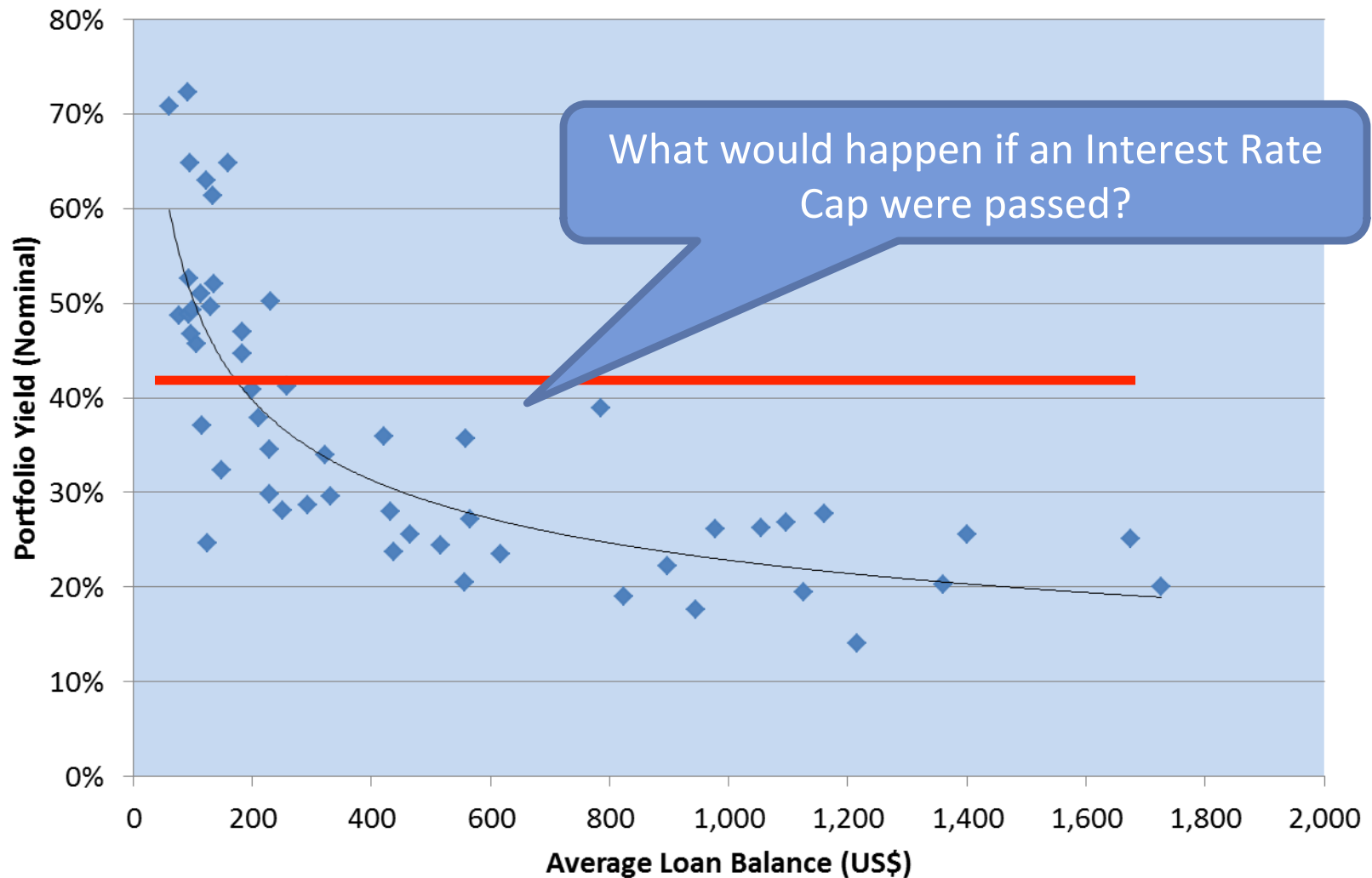
Portfolio Yield vs Average Loan Balance Philippines, 59 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

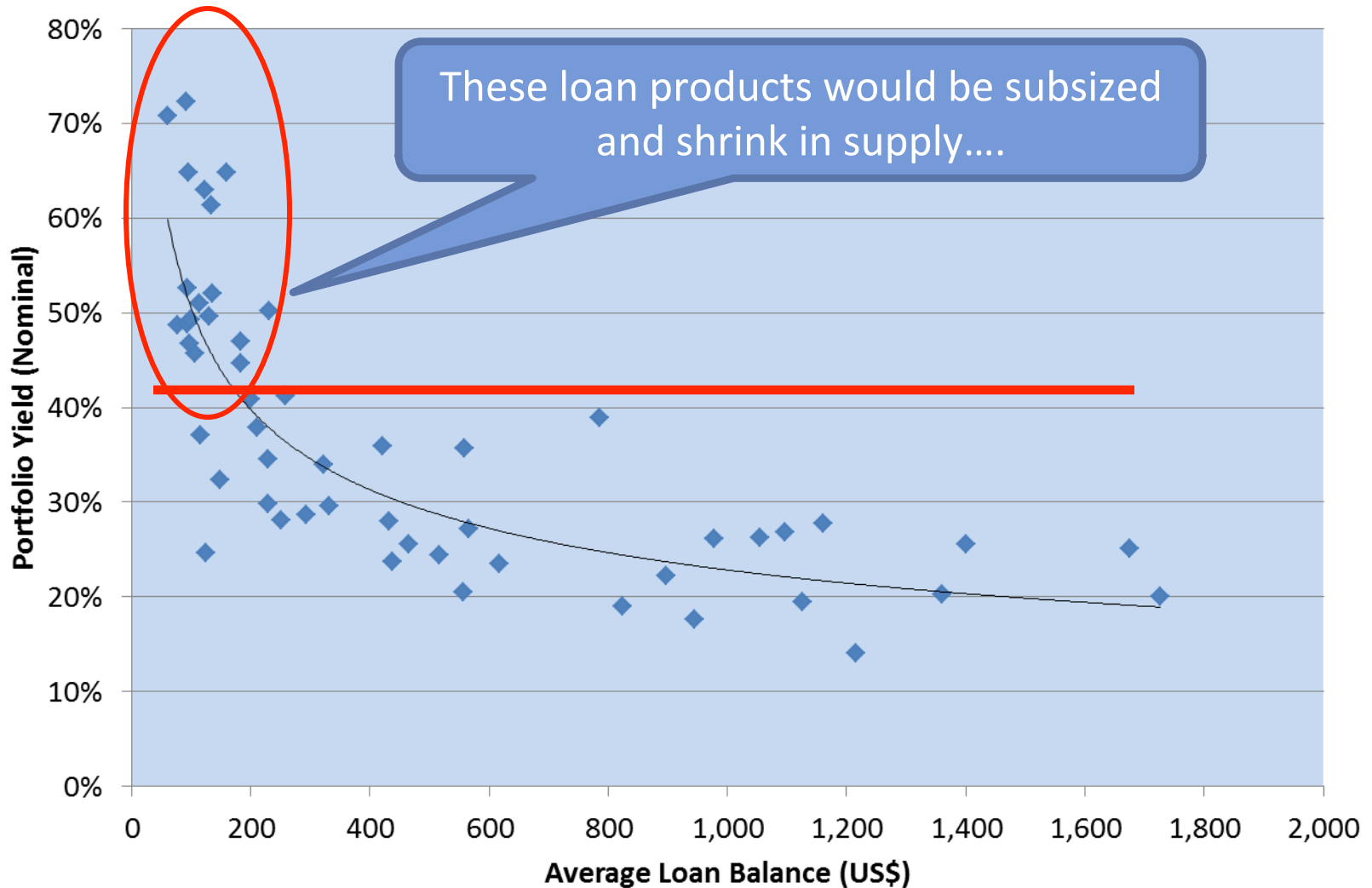
Portfolio Yield vs Average Loan Balance Philippines, 59 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

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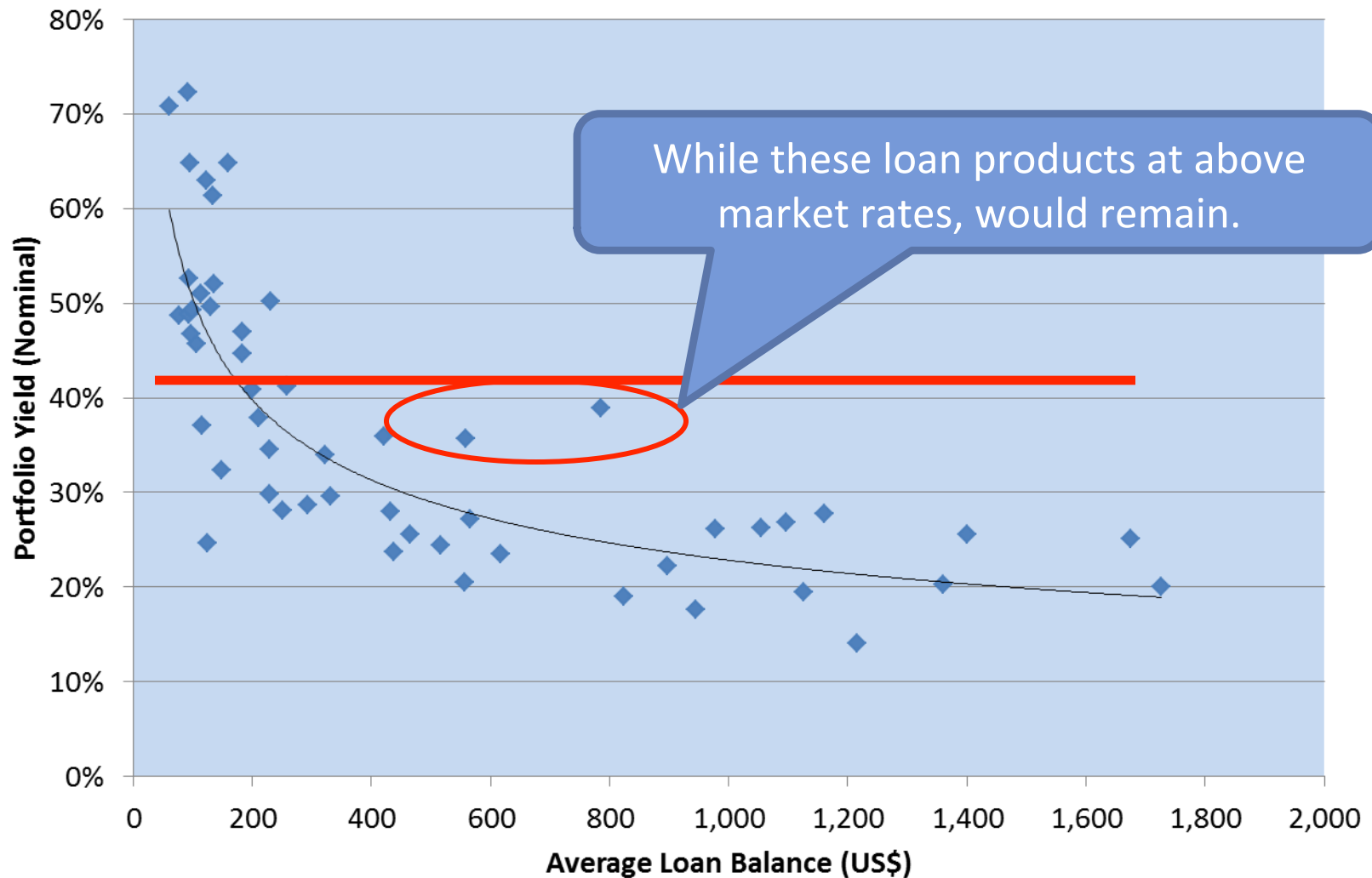


These loan products would be subsize and shrink in supply....

◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

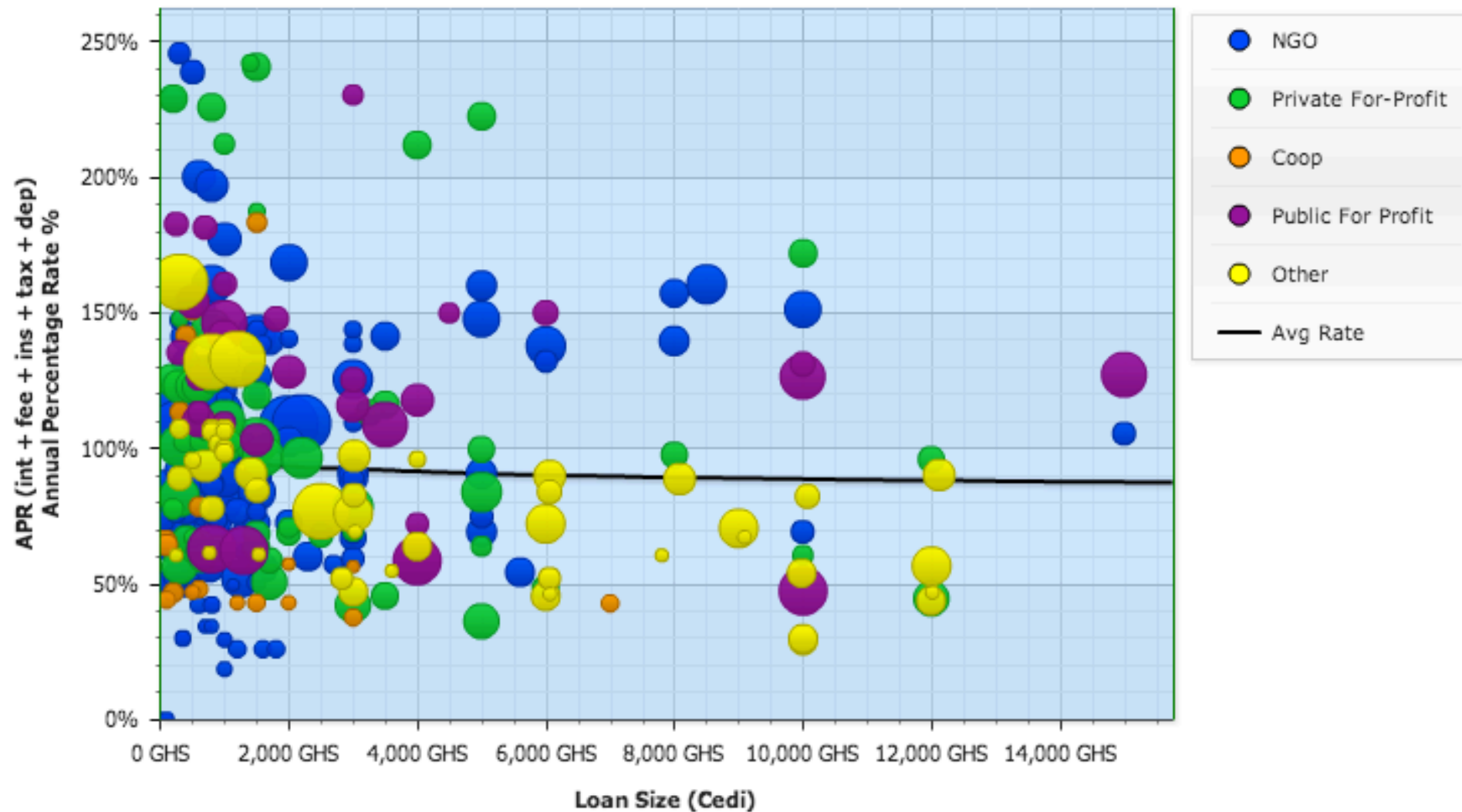
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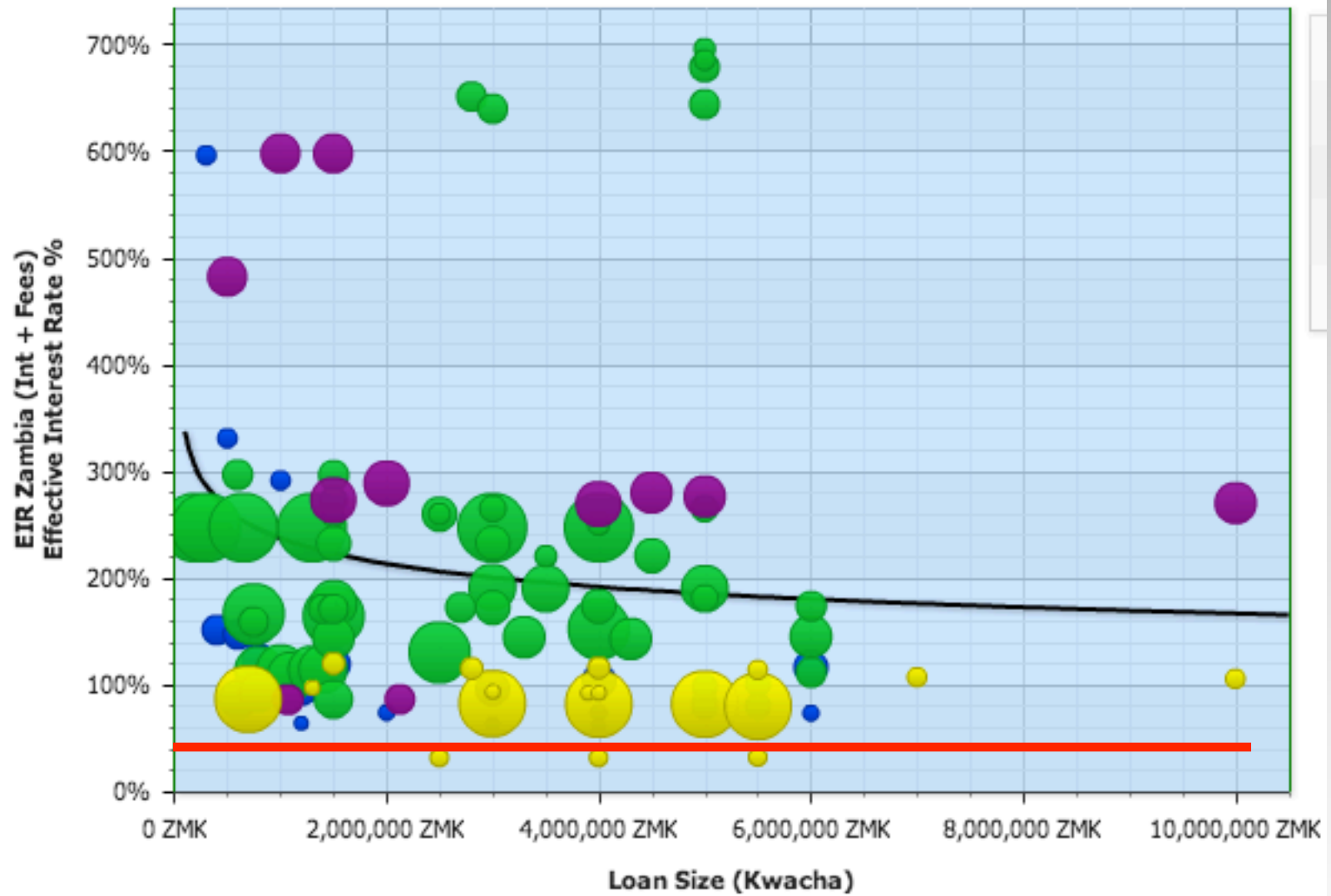
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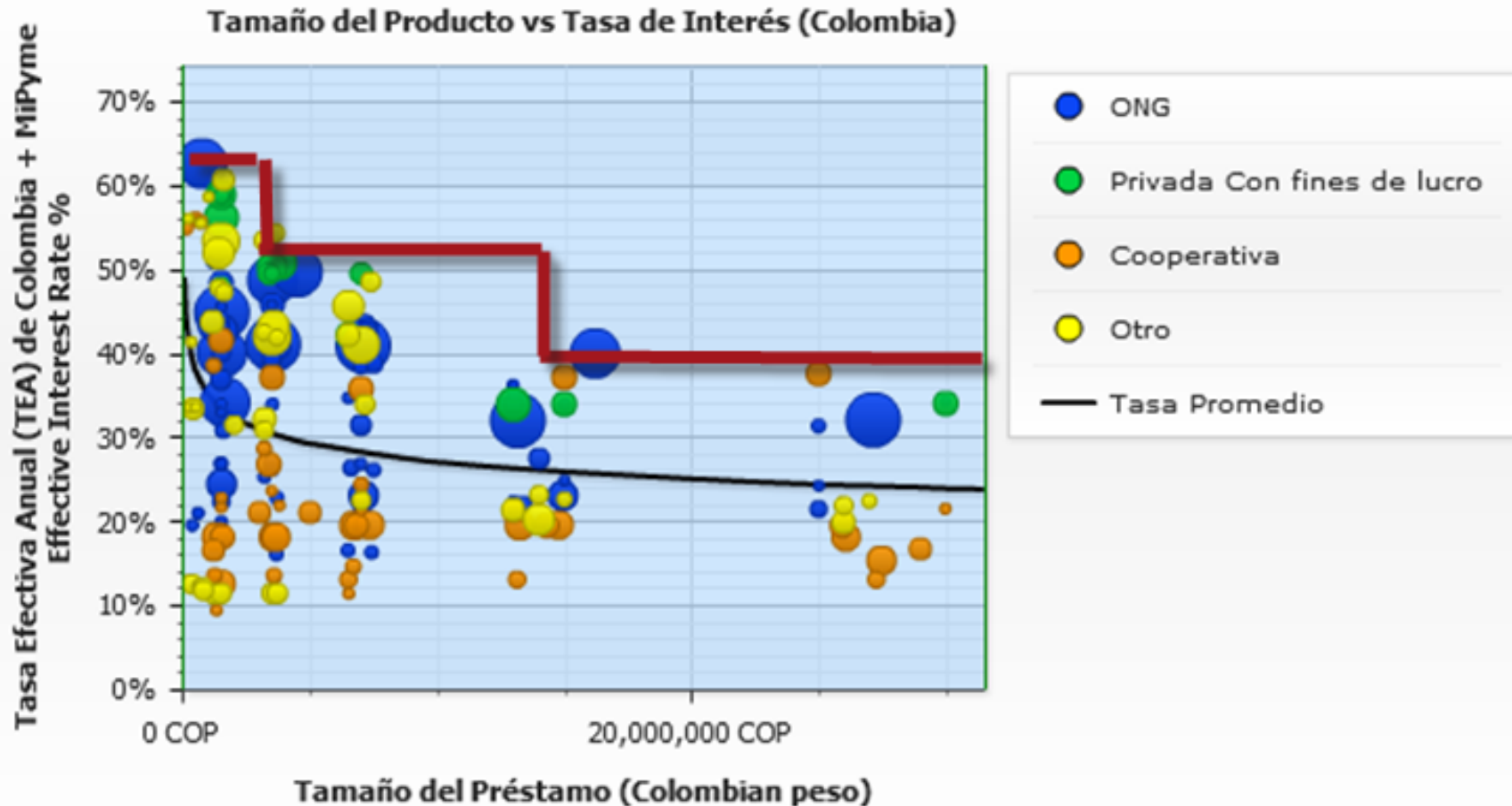
Product Size vs Interest Rate (Ghana)



Product Size vs Interest Rate (Zambia)



Colombia has a 3-tier price cap (showing values from 2011)



Transparency is essential

**Price Caps without Transparency
still leave a market overrun in
confusion**

Prices just aren't hidden from others— They aren't really known to us!

*Non-transparent prices introduce a serious market imperfection
that affects all stakeholders*

- **Consumers** – They cannot make informed decisions
- **MFIs** – Most do not even know if their price is competitive, because they don't know the true price of their competitors
- **Investors** – Making investment decisions without knowing the true price charged clients leaves potential of reputational risk
- **Regulators** – They cannot monitor the market and understand it without this information



Promoting Transparent Pricing in the Microfinance Industry

MicroFinance Transparency is an NGO registered in the USA

