

# THE NEED FOR TRANSPARENCY

 **mf**transparency.org

# Four Key Points on Pricing Transparency

1. We operate in an industry where **non-transparent pricing is common**
2. **Interest rates** vary significantly relative to **loan size**, making transparency difficult
3. Non-transparent pricing creates a **serious market imperfection**, generating the potential for high profits from lending to the poor
4. **Pricing transparency is essential** to well-functioning markets, promoting efficiency, healthy competition, and better prices for millions of poor people

# A Significant Industry Turning Point

- » What the industry has done up to the present:
  - Decades of **innovation and testing**, resulting in dramatic success
  - *Strong* efforts to raise a **solid public image** of microfinance
  - *Strong* efforts to **attract investor money** into the industry
  - **Weak efforts in consumer protection** policies and transparency
- » What are the implications of our past actions?
  - » We have laid the groundwork attracting a new contingent of actors to enter the industry, but **we have neglected to build any serious checks-and-balances** necessary to protect the poor

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# Which Loan Costs the Most?

	Loan A	Loan B	Loan C
Amount	\$500	\$500	\$500
Rate	4%	2.5%	75%
Per	Month	Month	Year
Type of Interest	Flat	Flat	Declining
Fees	1%	1.5%	2%
Term	6 months	3 months	1 year
Pmt Frequency	Weekly	Every 2 weeks	Monthly
Comp. Savings	None	20%	None
Int. on Savings		5%	

# Which Loan Costs the Most?

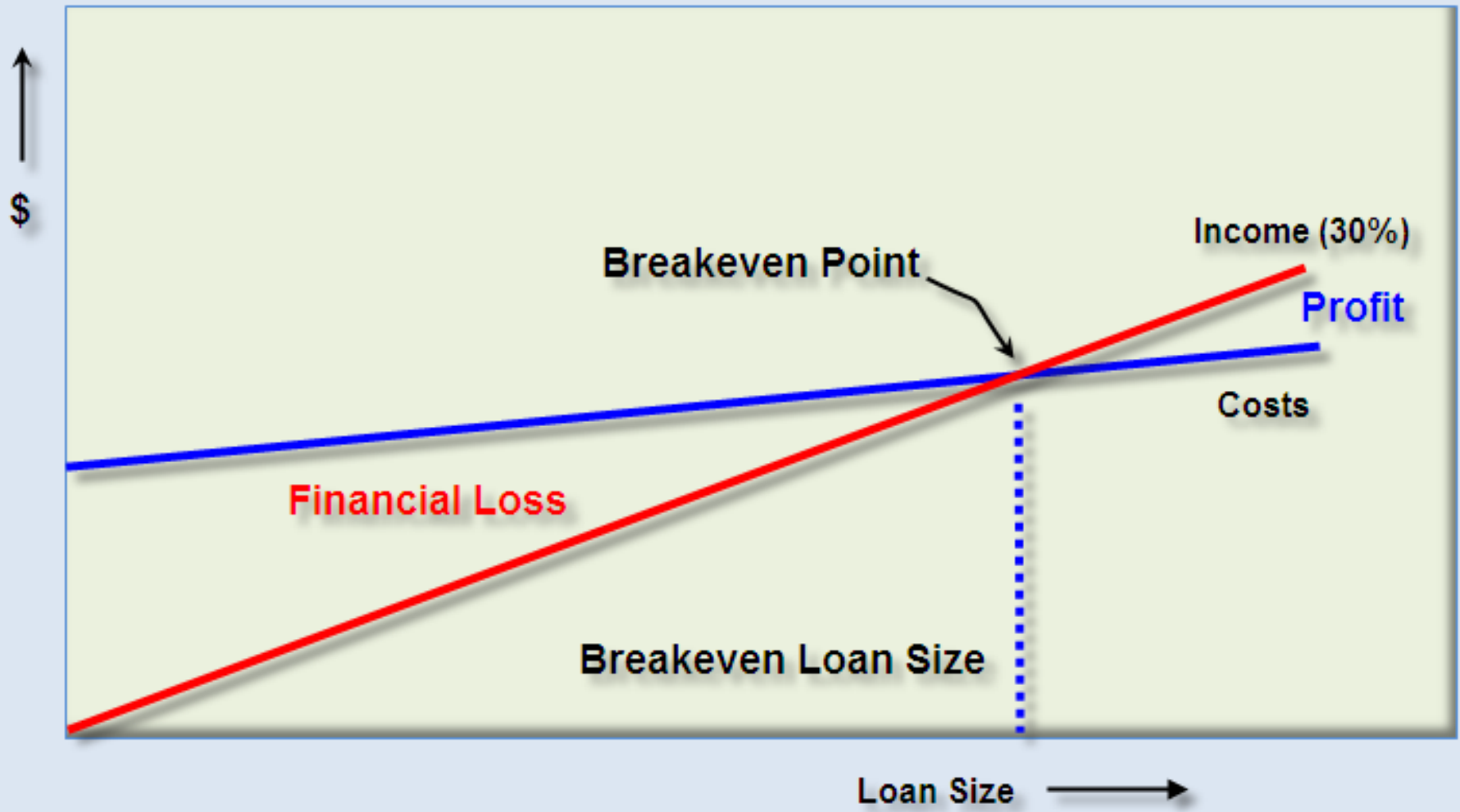
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<b>APR</b>	<b>88.48%</b>	<b>90.67%</b>	<b>79.48%</b>

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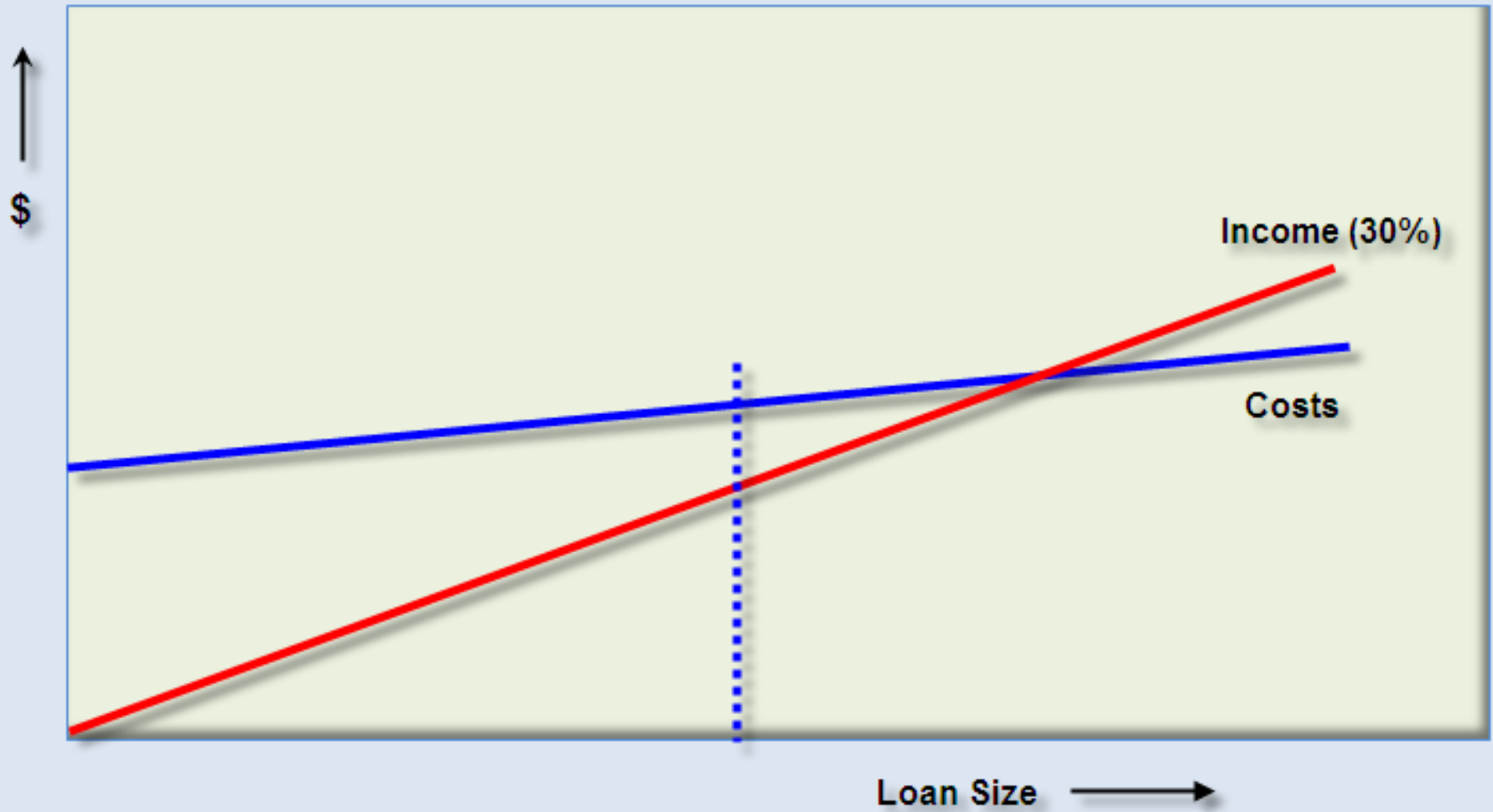
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# What is Costs to Lend to the Poor

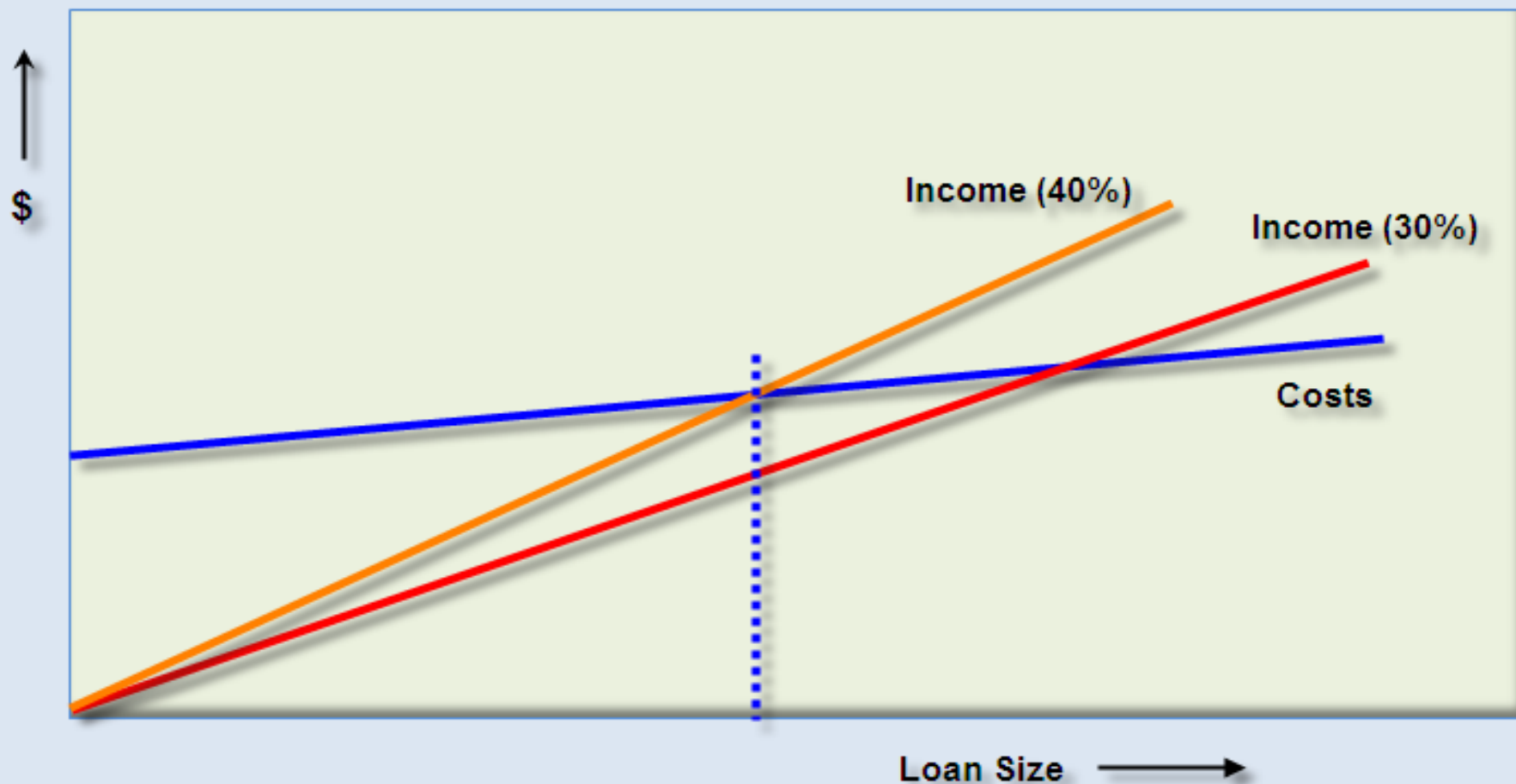
Breakeven Points related to Loan Size and Interest Rate



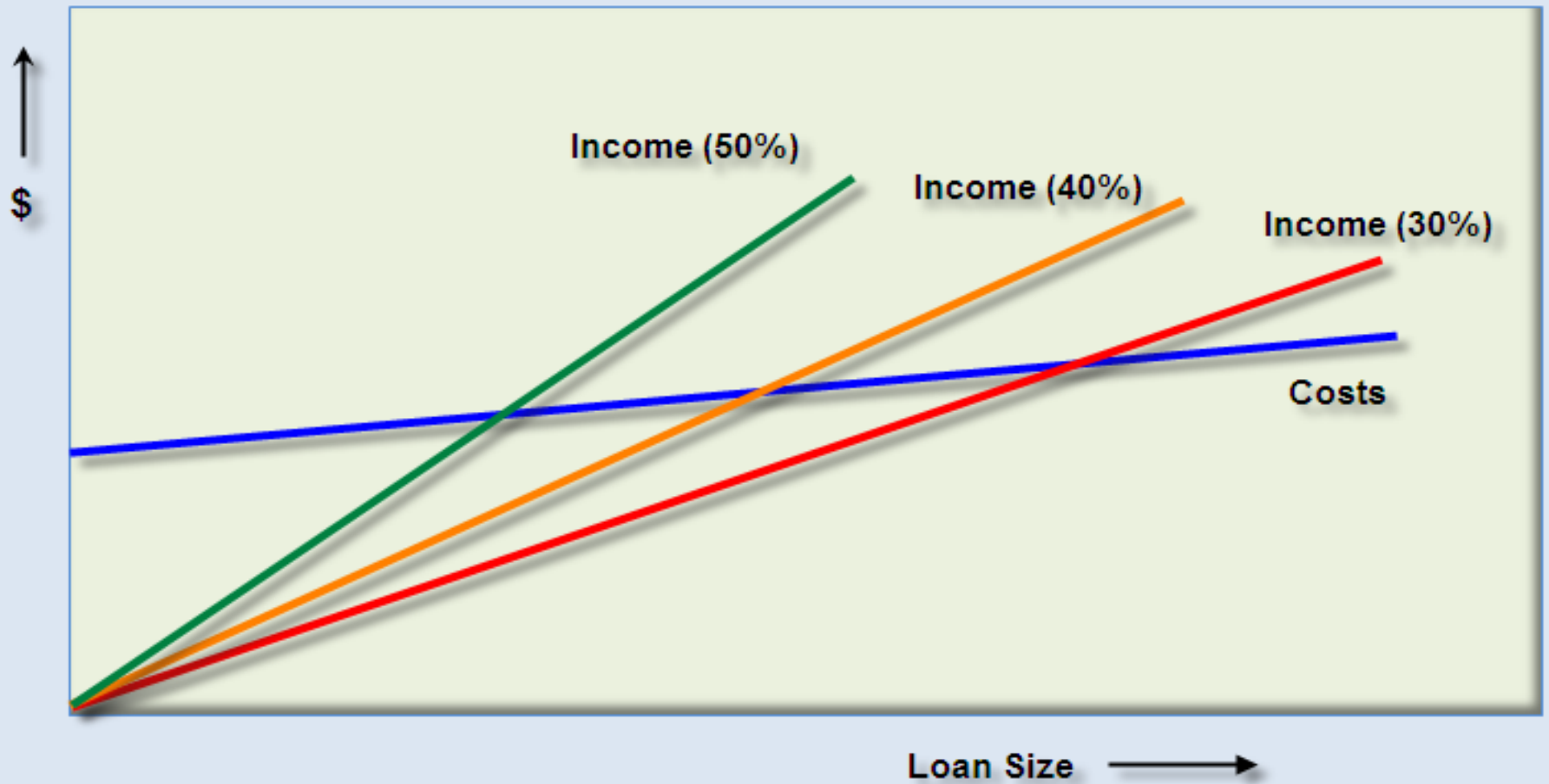
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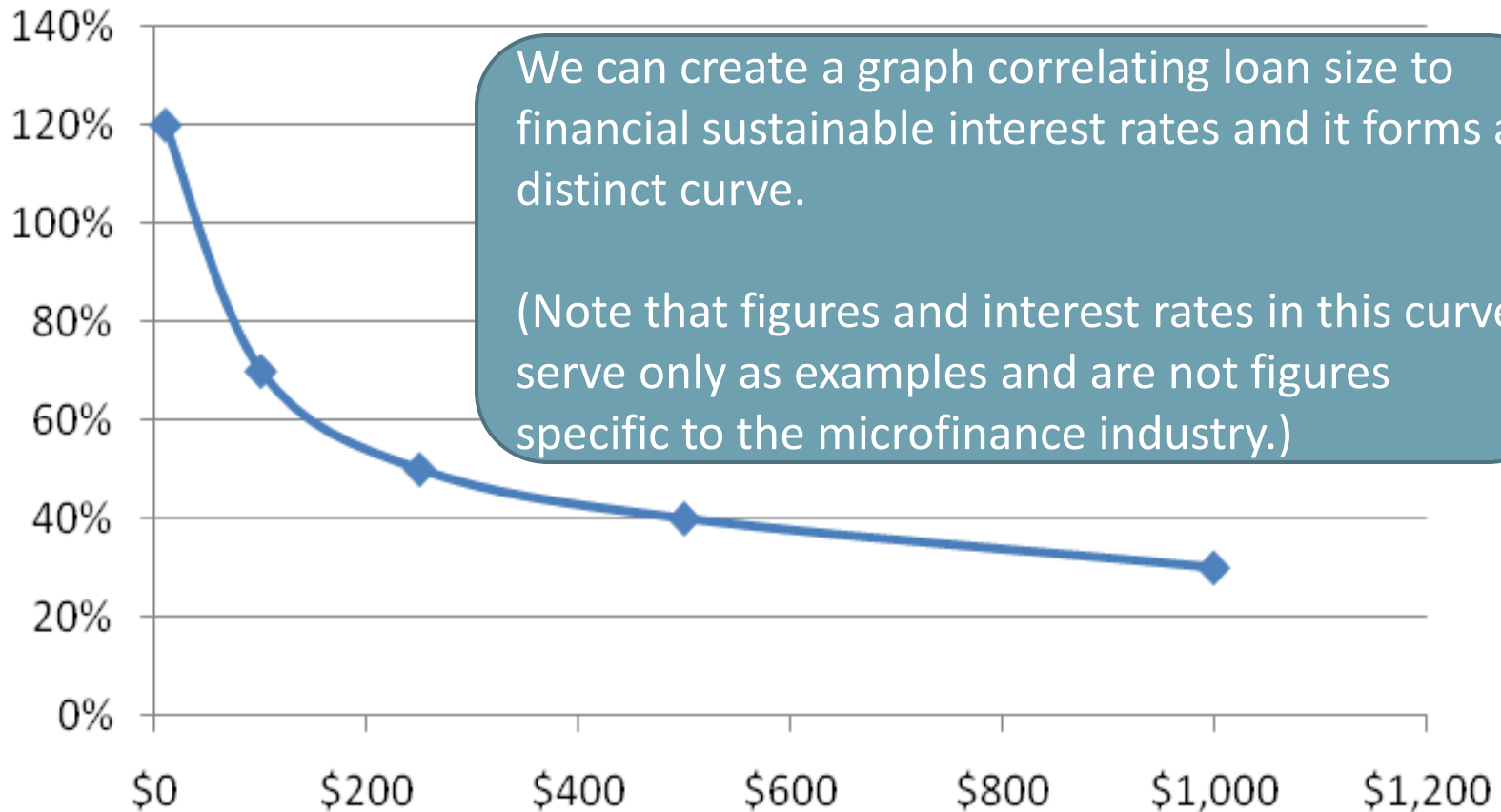
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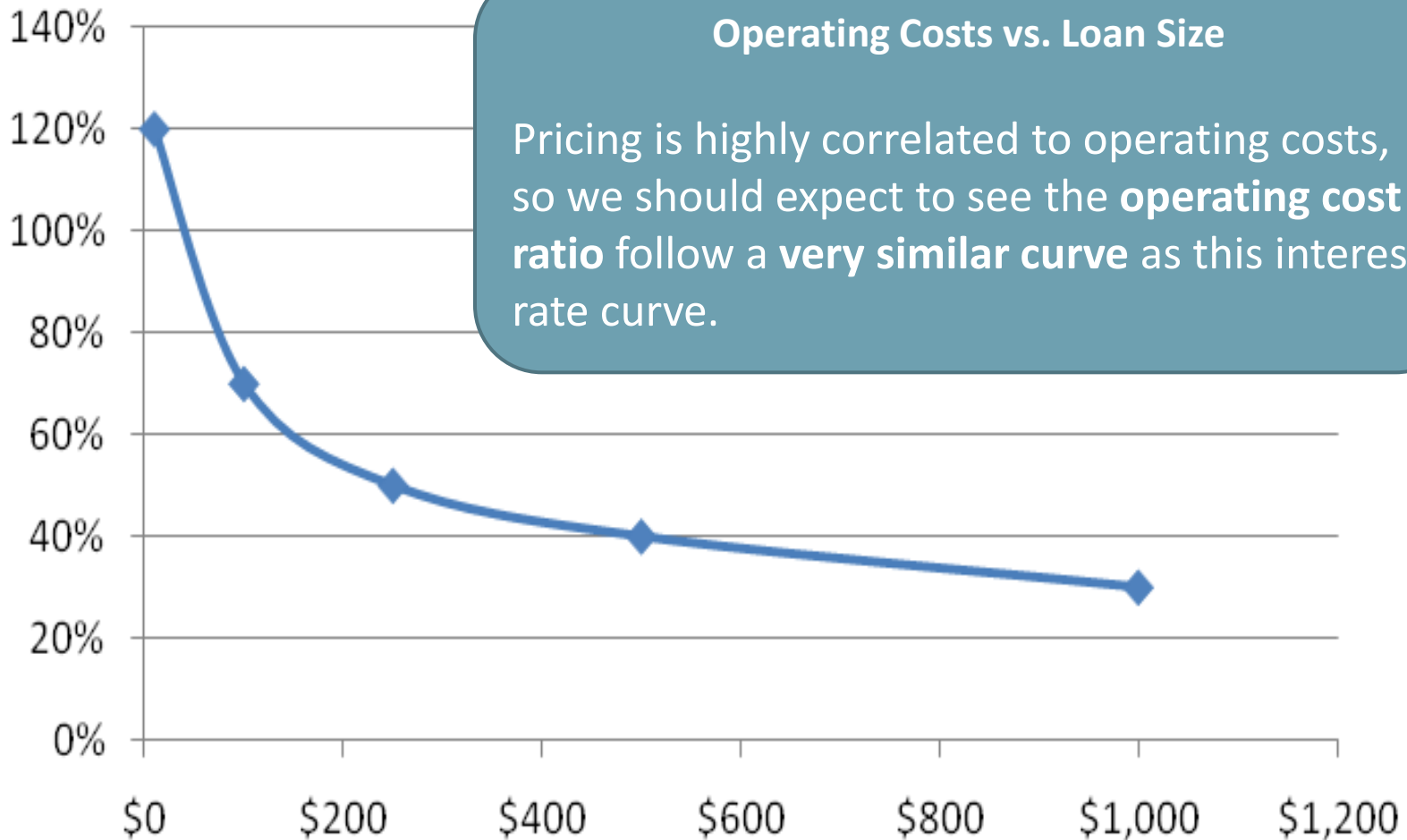


# Interest Rate and Loan Size



**Higher costs for smaller loan amounts require significantly higher interest rates for sustainability**

# Interest Rate and Loan Size



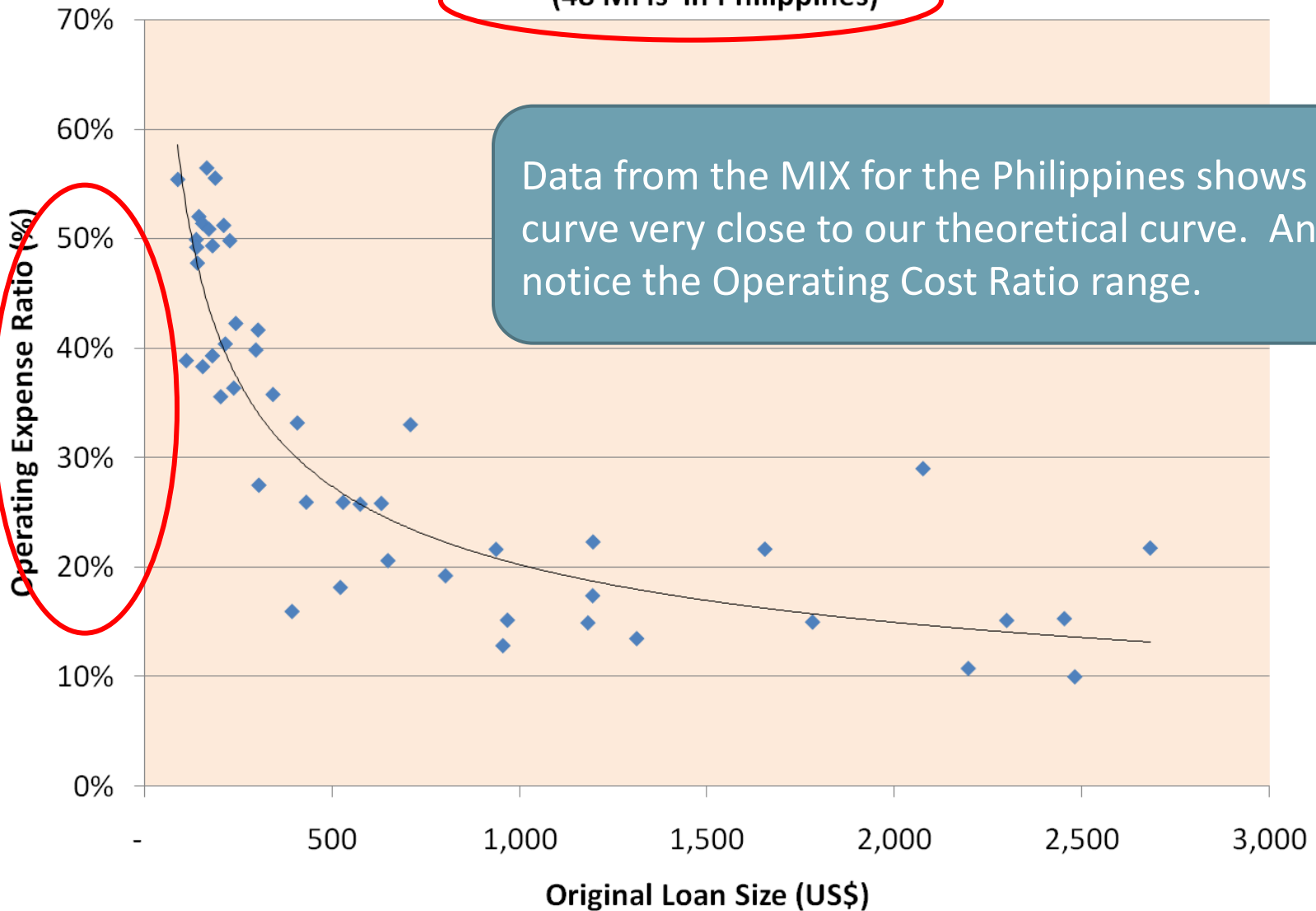
## Operating Costs vs. Loan Size

Pricing is highly correlated to operating costs, so we should expect to see the **operating cost ratio** follow a **very similar curve** as this interest rate curve.

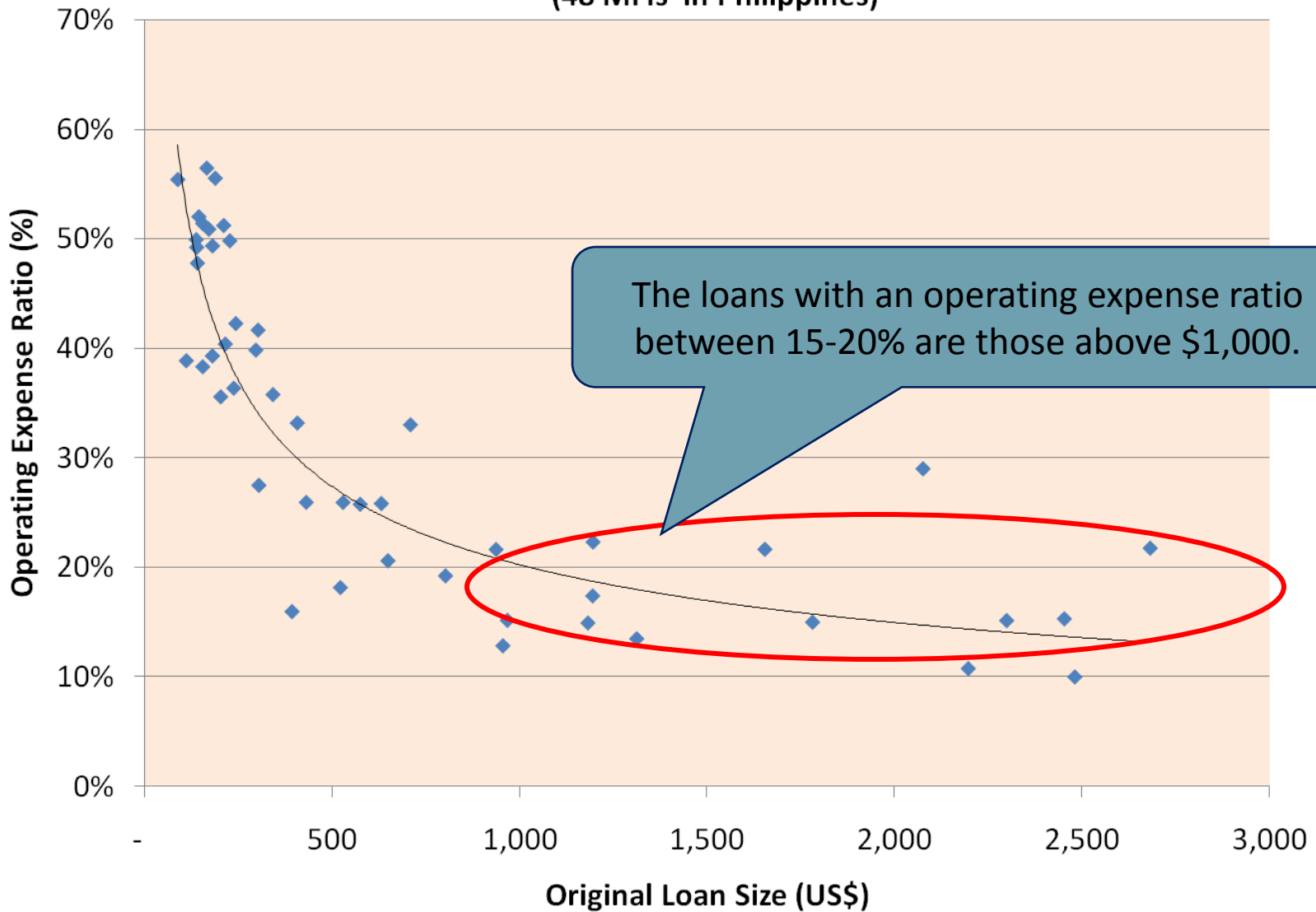
# What Does it Cost to Make a Micro Loan?

a	Original Loan Amount	\$50	\$100	\$200	\$300	\$500	\$750	\$1,000
	<b>Operating Cost Calculation</b>							
k	Cost to initiate loan	\$10	\$15	\$25	\$30	\$40	\$50	\$50
l	Annual initiation costs	\$10	\$15	\$25	\$30	\$40	\$50	\$50
m	Monthly loan monitoring cost					\$4	\$5	\$5
n	Annual monitoring cost	\$0	\$0	\$0	\$0	\$48	\$60	\$60
o	Total Annual Operating Costs	\$10	\$15	\$25	\$30	\$88	\$110	\$110
p	<i>Average Outstanding Balance</i>	\$25	\$50	\$100	\$150	\$250	\$375	\$500
q	<b>Annual Operating Cost Ratio</b>					<b>35%</b>	<b>29%</b>	<b>22%</b>

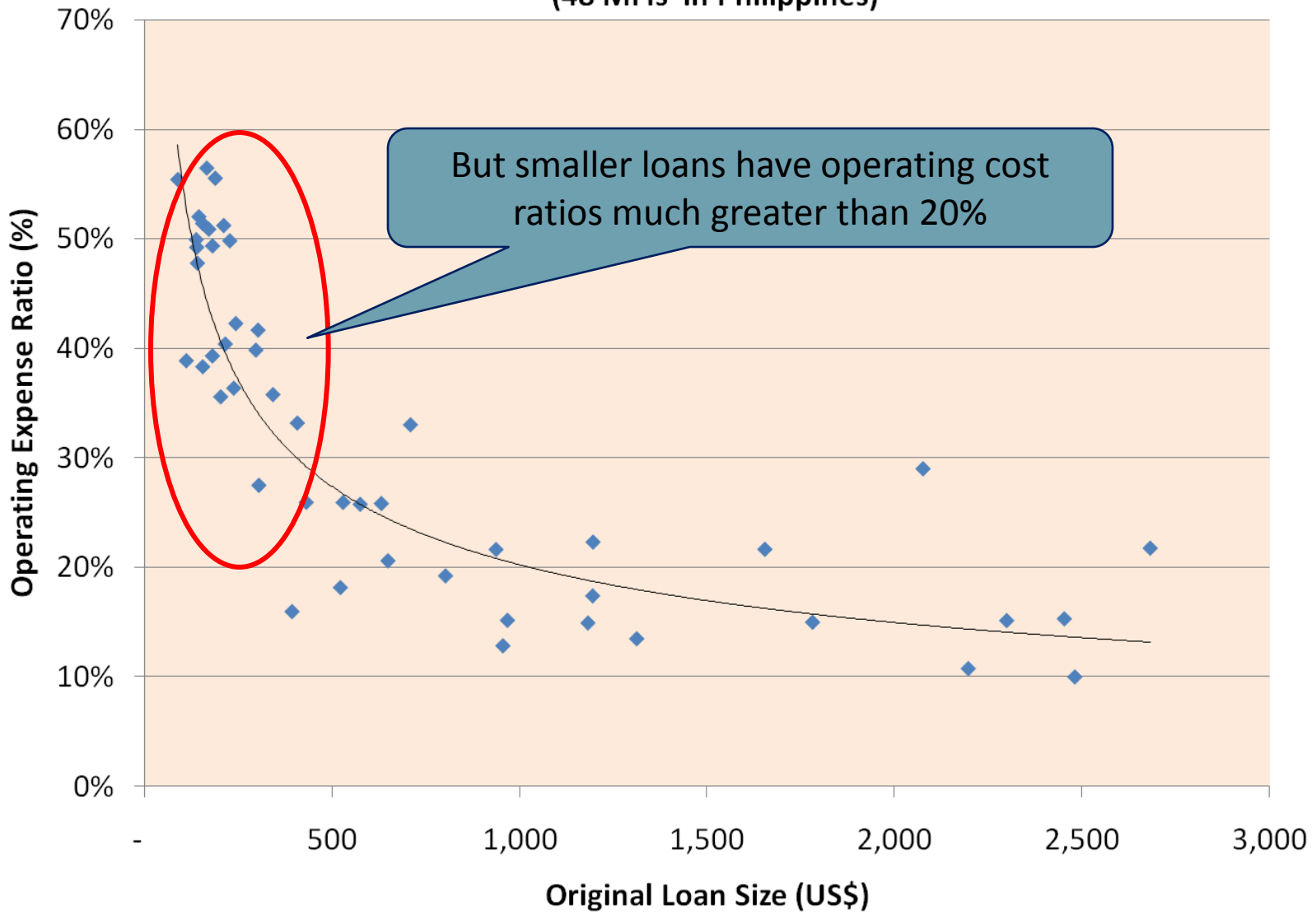
## Loan Size and Op Exp/Port % (48 MFIs in Philippines)



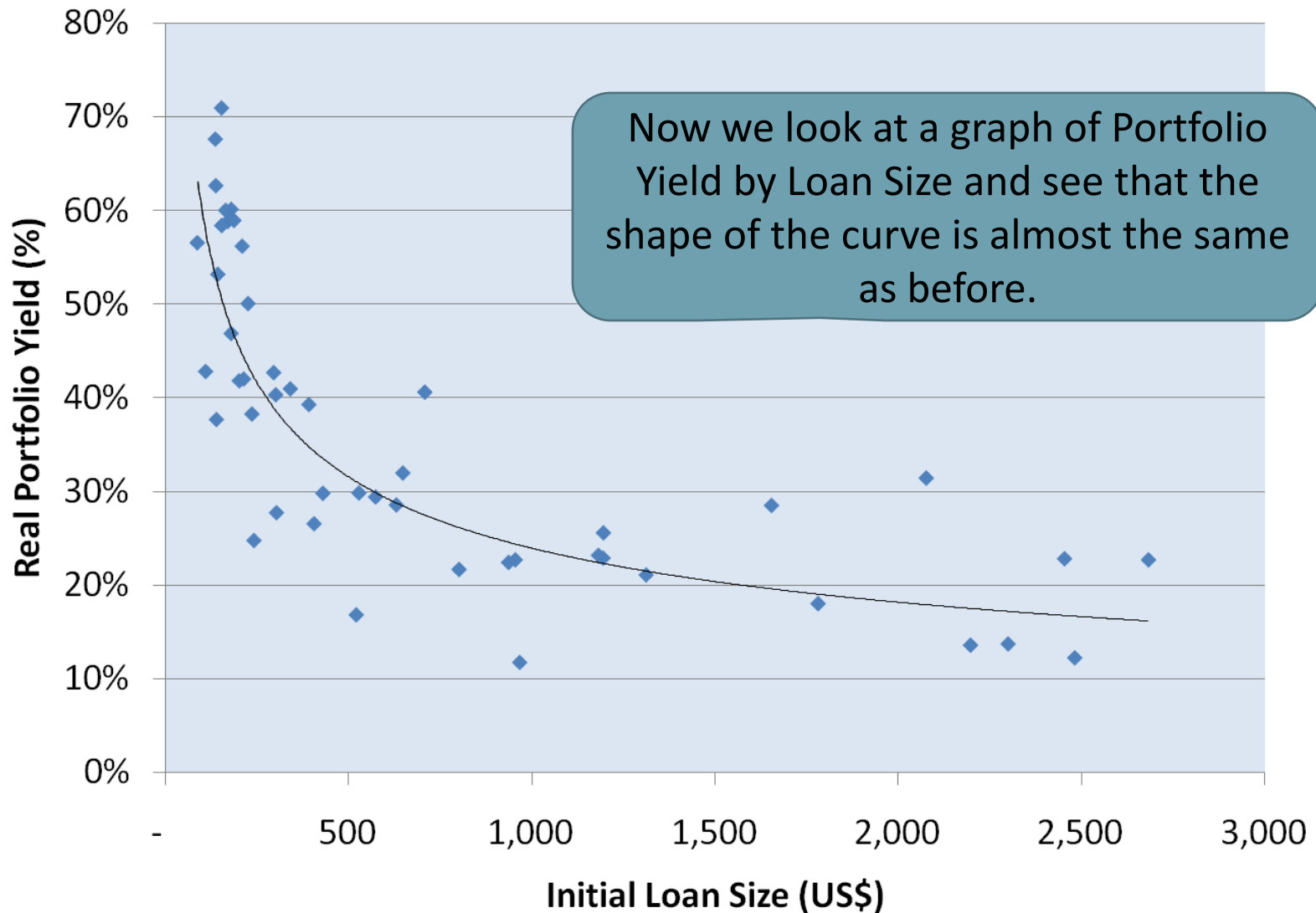
## Loan Size and Op Exp/Port % (48 MFIs in Philippines)



# Loan Size and Op Exp/Port % (48 MFIs in Philippines)



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



# How Can the Poor Afford Such High Rates of Interest?

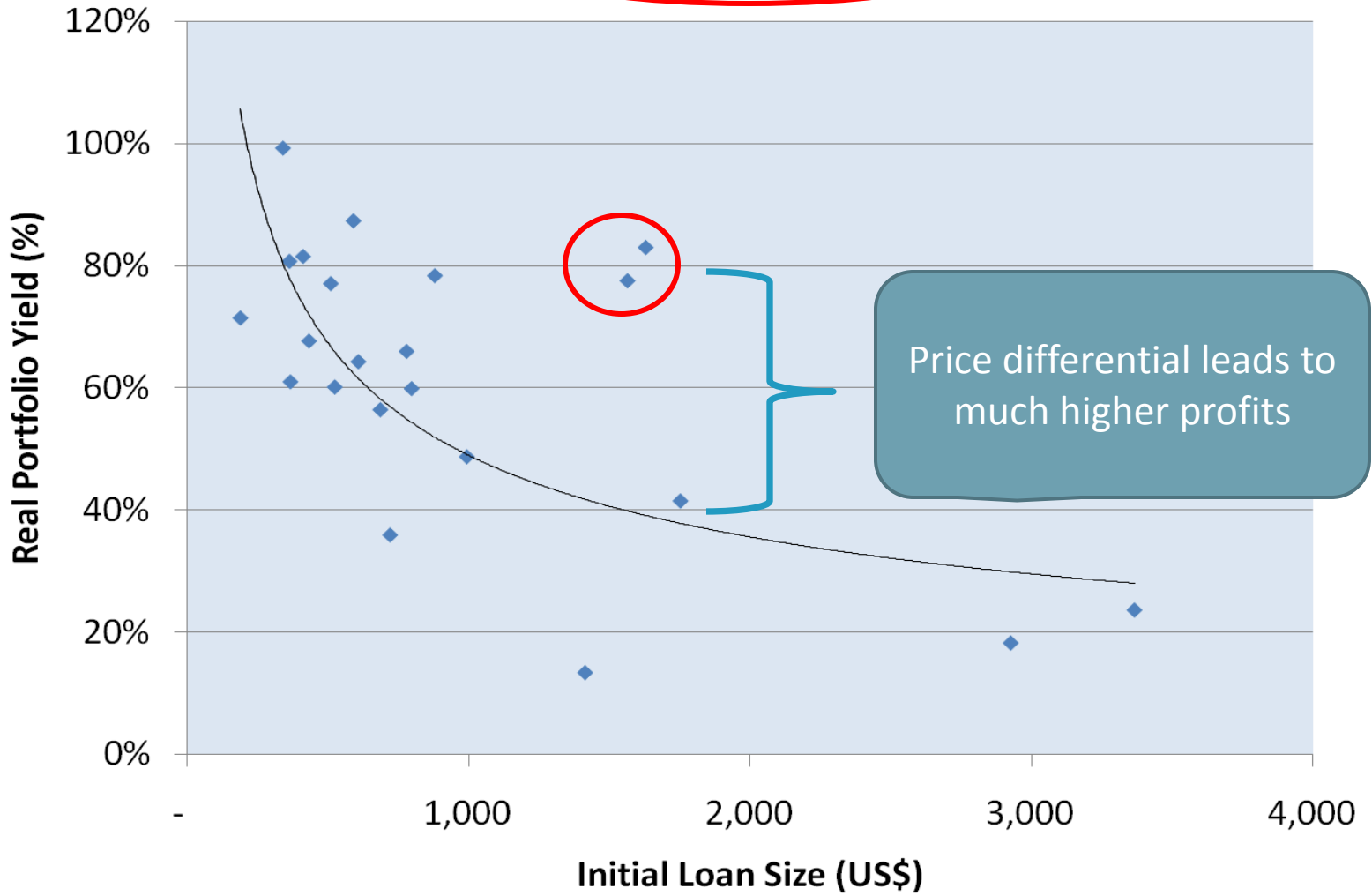
- \$500 Loan
- 6 months
- Weekly Repayments
- 1% Fee
- @ 2% per month (49% APR)  
weekly payment =
- \$23.14
- What will the weekly payment be at 4% per month (91% APR)?
- \$25.45

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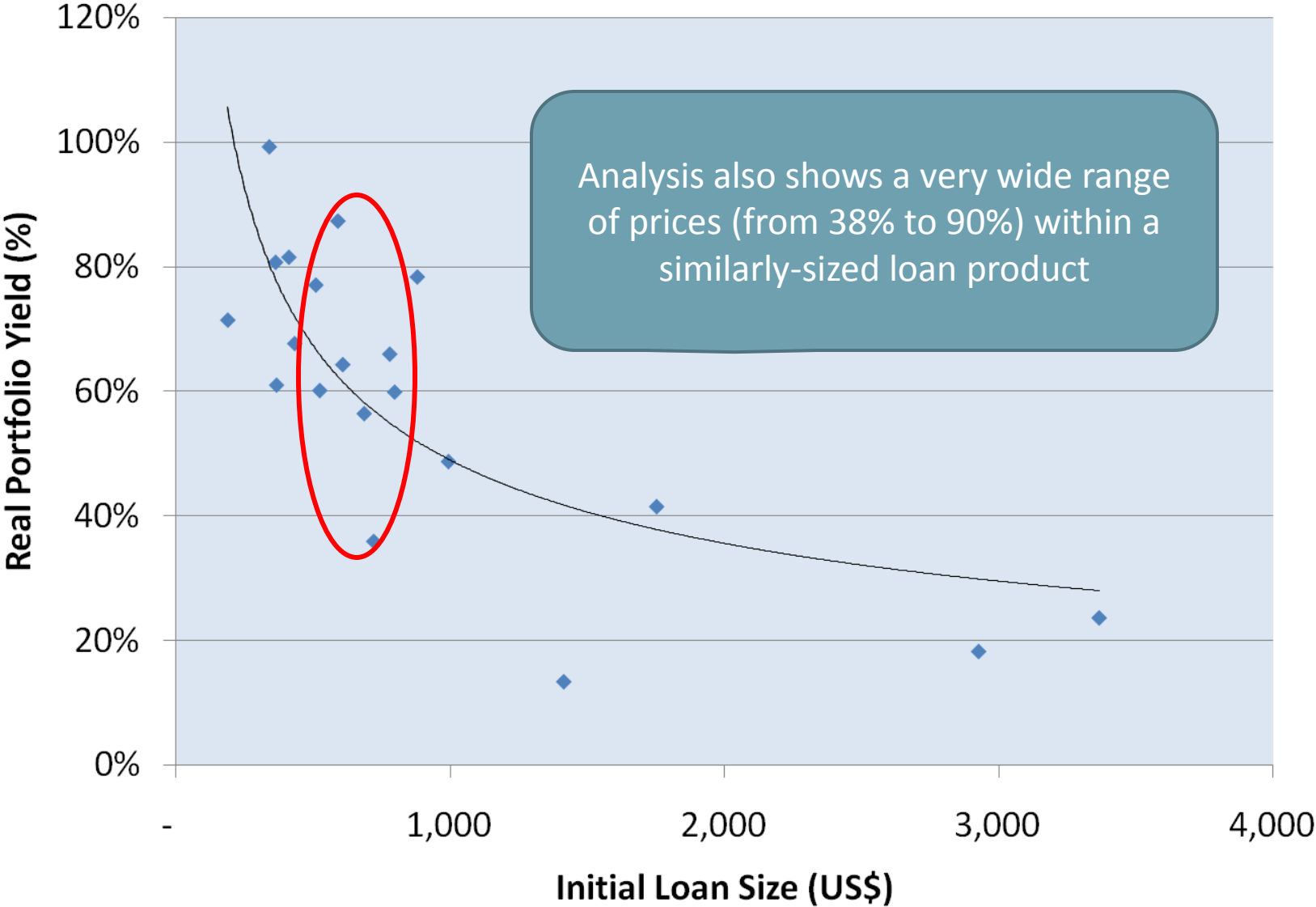
# Loan Size and Real Portfolio Yield

(22 MFIs in Mexico)



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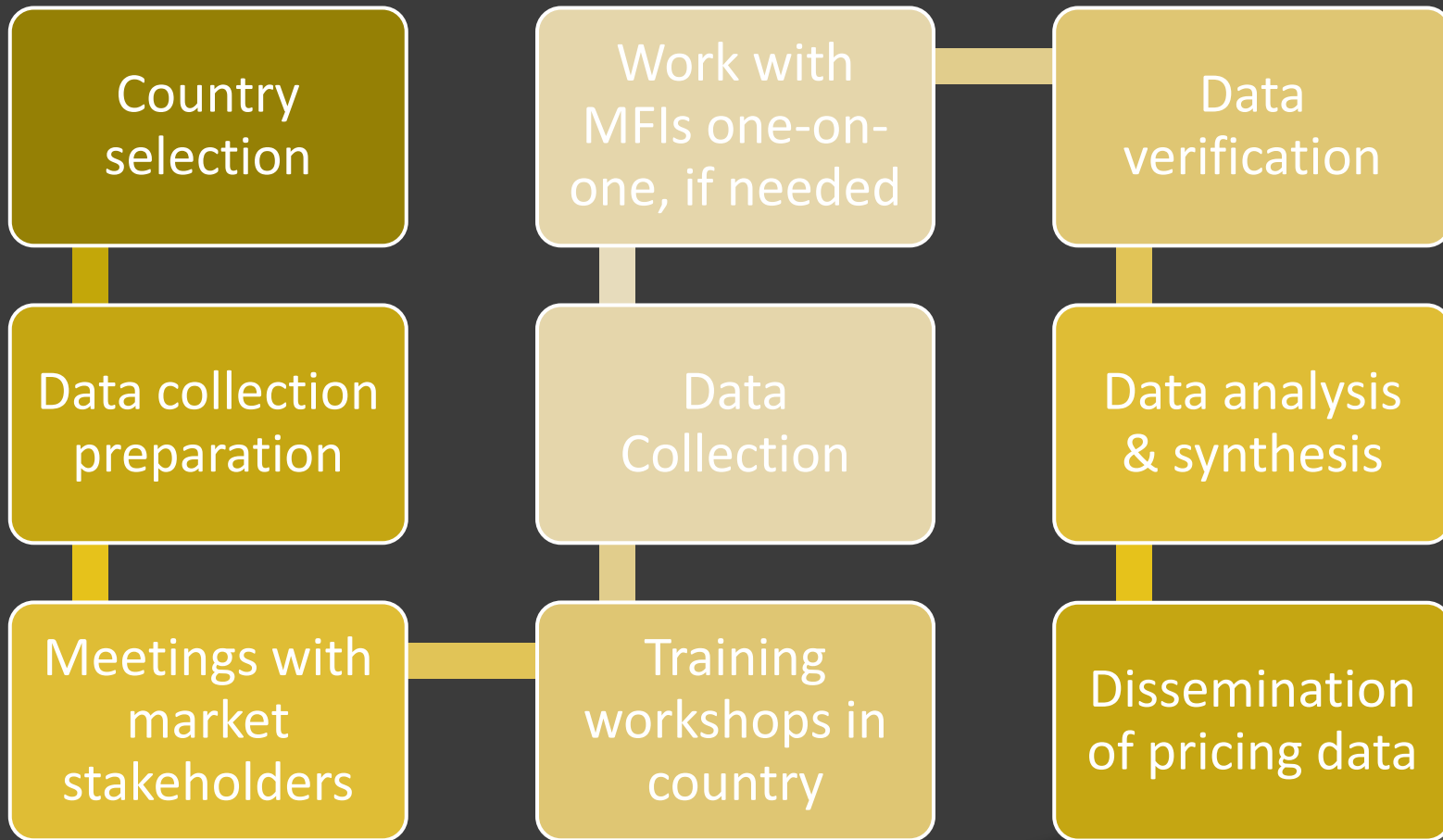
# Why has microfinance not practiced transparency?

1. Financial products are possibly the most complex products to understand the price of
2. Therefore, the financial industry has invented many ways to make products look less expensive than they really are
3. Microfinance has followed in the footsteps of the finance industry

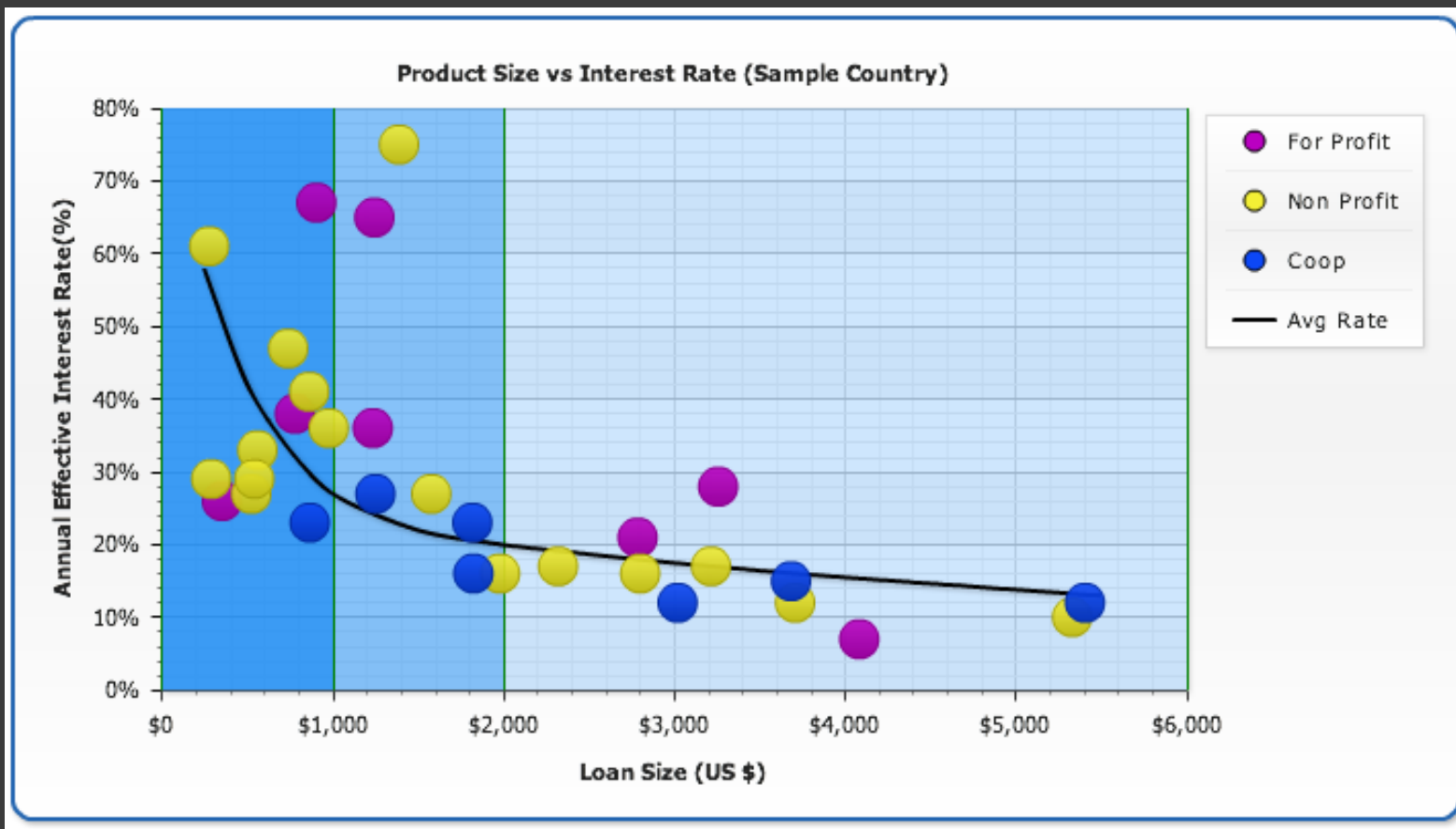
# How Do We Get Transparency with Context?

- ⦿ Collect data on each loan product from each microfinance lender
  - Interest and Fees
  - Term and repayment frequency
  - Savings
  - Grace periods
  - Average Size
- ⦿ Calculate the APR for each product
- ⦿ Produce a graph of the APR by loan size

# How does MFT work?



# Data Output - Sample Graph



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# Competitive markets need transparency



Leaders from Britain, France and Germany have called for rules for financial institutions that would ensure improved governance and greater transparency



A lack of transparency led us into this situation, and only an abundance of transparency can deliver us to better times.

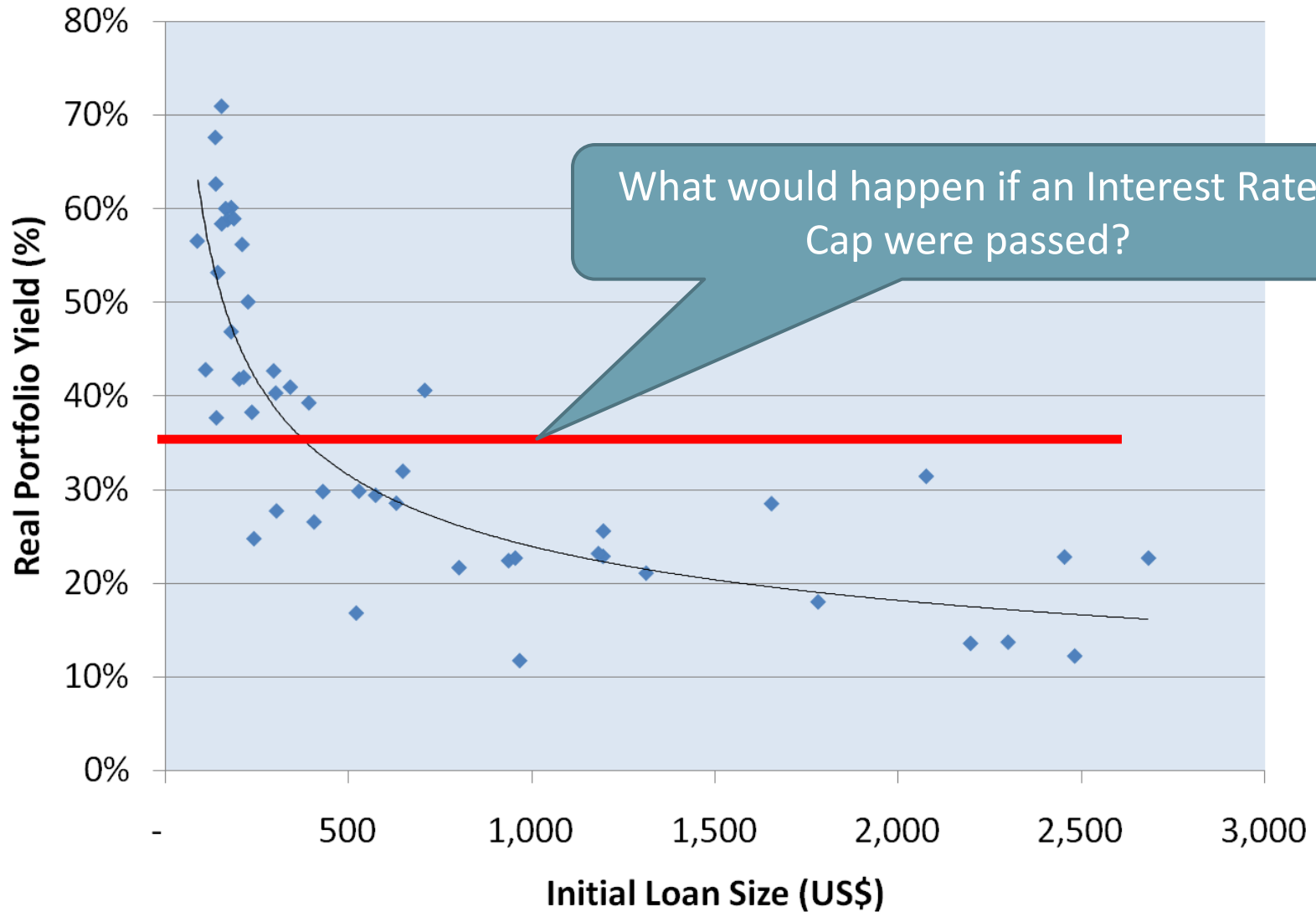
Kris Gopalakrishnan, founder and CEO, Infosys



“The marketplace is broken...markets don’t work when certain elements of the competition or certain elements among the products are not visible.”

Elizabeth Warren, Harvard Professor and TARP Watchdog

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







# What can MFIs, Investors and Regulators do to Promote Interest Rate Transparency?



# Thank you!

Larry Reed

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# Sponsors & Endorsers



79 MFIs

62 Industry Supporters

35 Independents

41 MFI Networks & Associations

MFI coverage: 29,163,178 22%

Apex coverage: 49,800,000 37%

**Total 78,963,178 59% of total clients in the world**

Total world clients: 133,000,000 counted by Microcredit Summit

# Promoting Transparent Pricing in the Microfinance Industry

