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July 20, 2011

# Microfinance Investment Transparency and Evaluation

**Sebastian von Stauffenberg**  
MicroRate



**Chuck Waterfield**  
MFTransparency



# Transparency in microfinance evaluation

# Growth through private capital

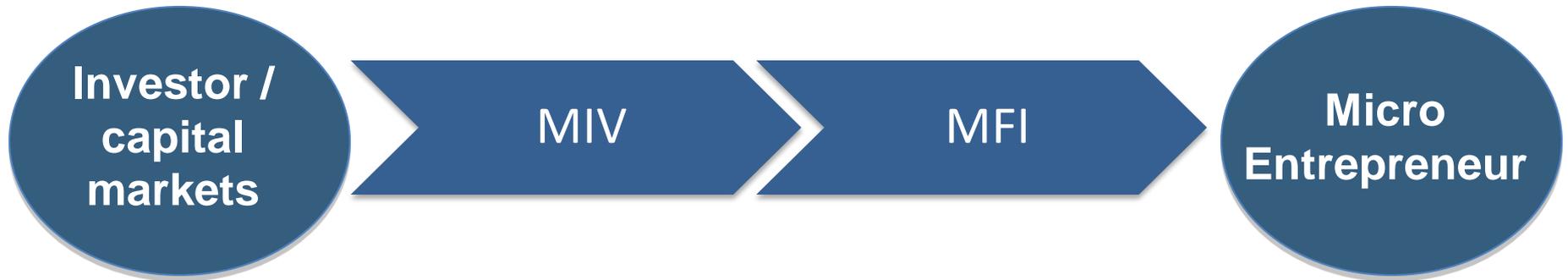
“Virtually any mature industry that has grown to scale and has attracted private capital has in place the following elements:”

1. **Common terminology**
2. **Transparency**
3. Adherence to standard accounting practices
4. Regulation by third parties
5. **Investment rating services**
6. **Fund comparison data**
7. Insurance
8. Liquidity through secondary markets

# About MicroRate

- First specialized microfinance rating agency
- Over 600 performance ratings of 250 MFIs
- 100 social ratings
- Pioneering achievements:
  - First microfinance rating in 1996 (Investment rating services)
  - Standardized financial indicators for MFIs (Common terminology)
  - Conducted the first rating of a microfinance CDO (Investment rating services)
  - Initiated the standardization of microfinance fund indicators (Fund comparison data)
  - Evaluations of Microfinance Investment Vehicles (MIVs) (Fund comparison data)

# MicroRate Vision



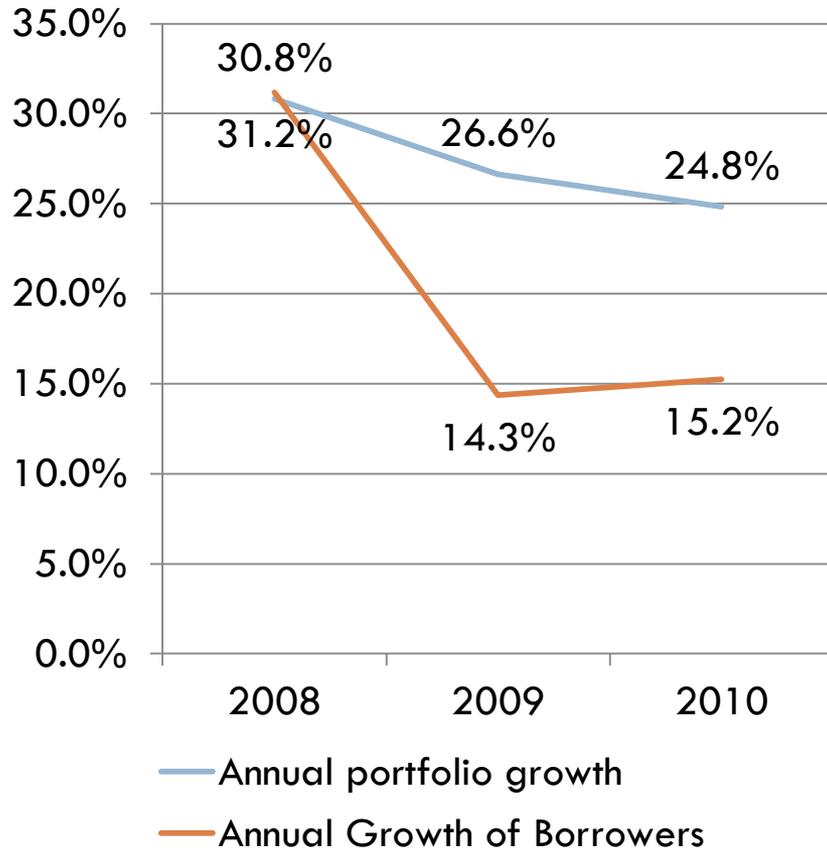
## ***Vision***

Promote the flow of funds from capital markets to microfinance by increasing transparency and growth in the global microfinance community.

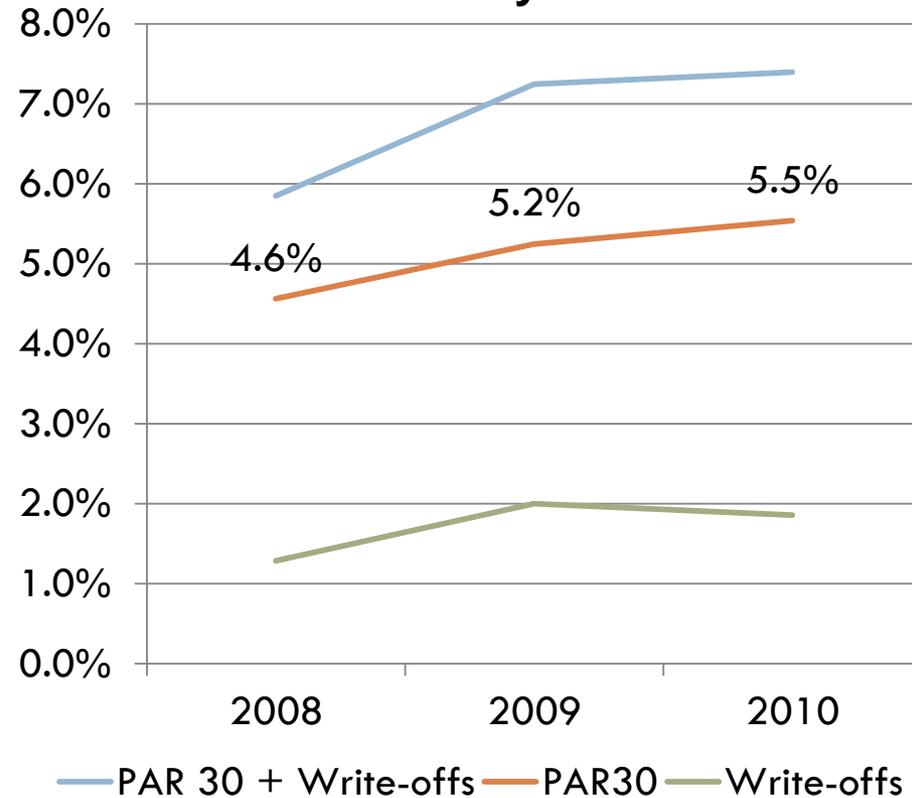
# General MFI Indicators



## Portfolio Growth Rates



## Portfolio Quality

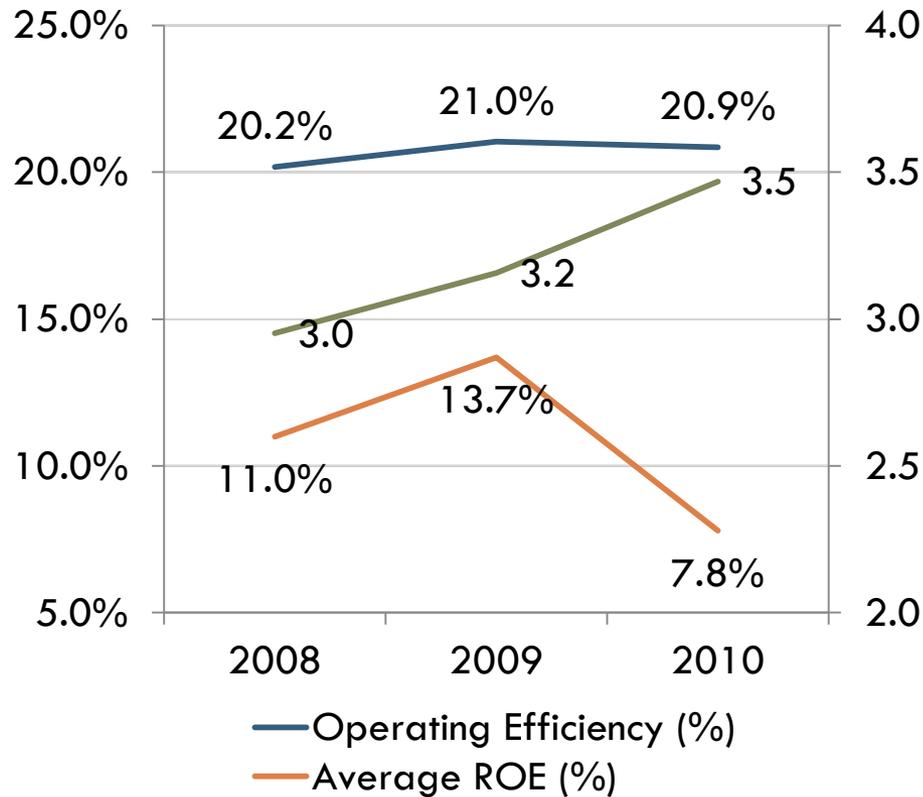


Based on a sample of 30 leading MFIs in Latin American

# General MFI Indicators



## Profitability



*Based on a sample of 30 leading MFIs in Latin America*

# MicroRate Performance Rating Methodology

Investor

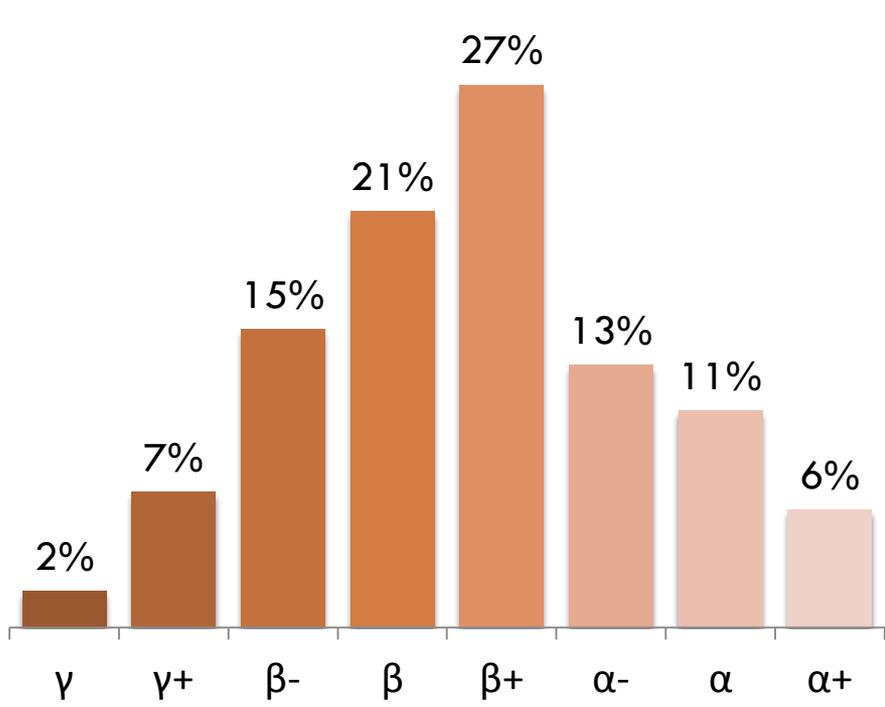
MIV

MFI

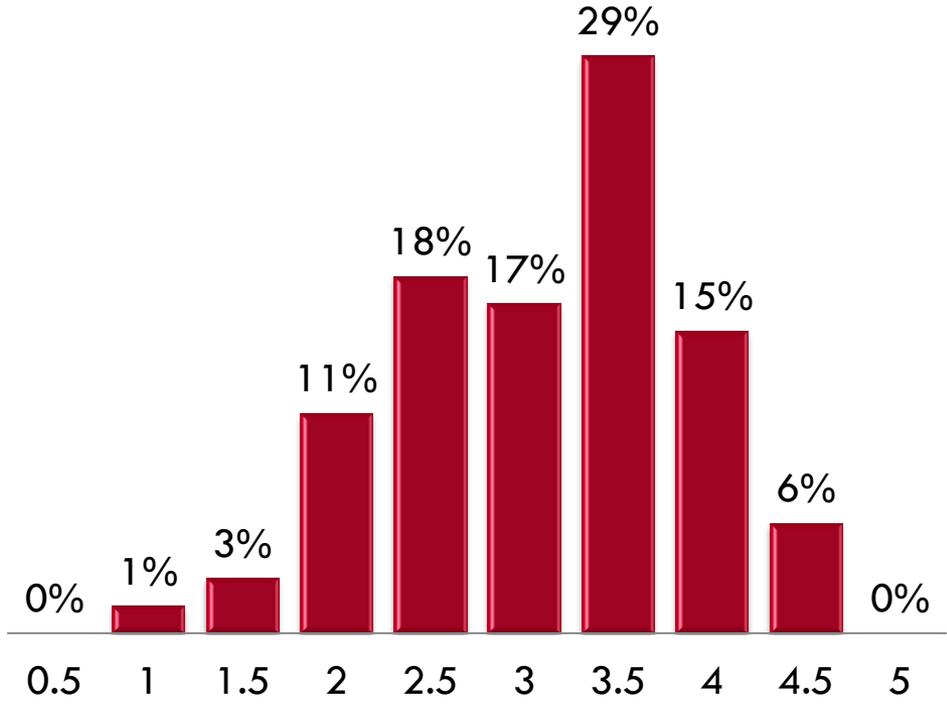
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# Rating Distribution



Performance Ratings



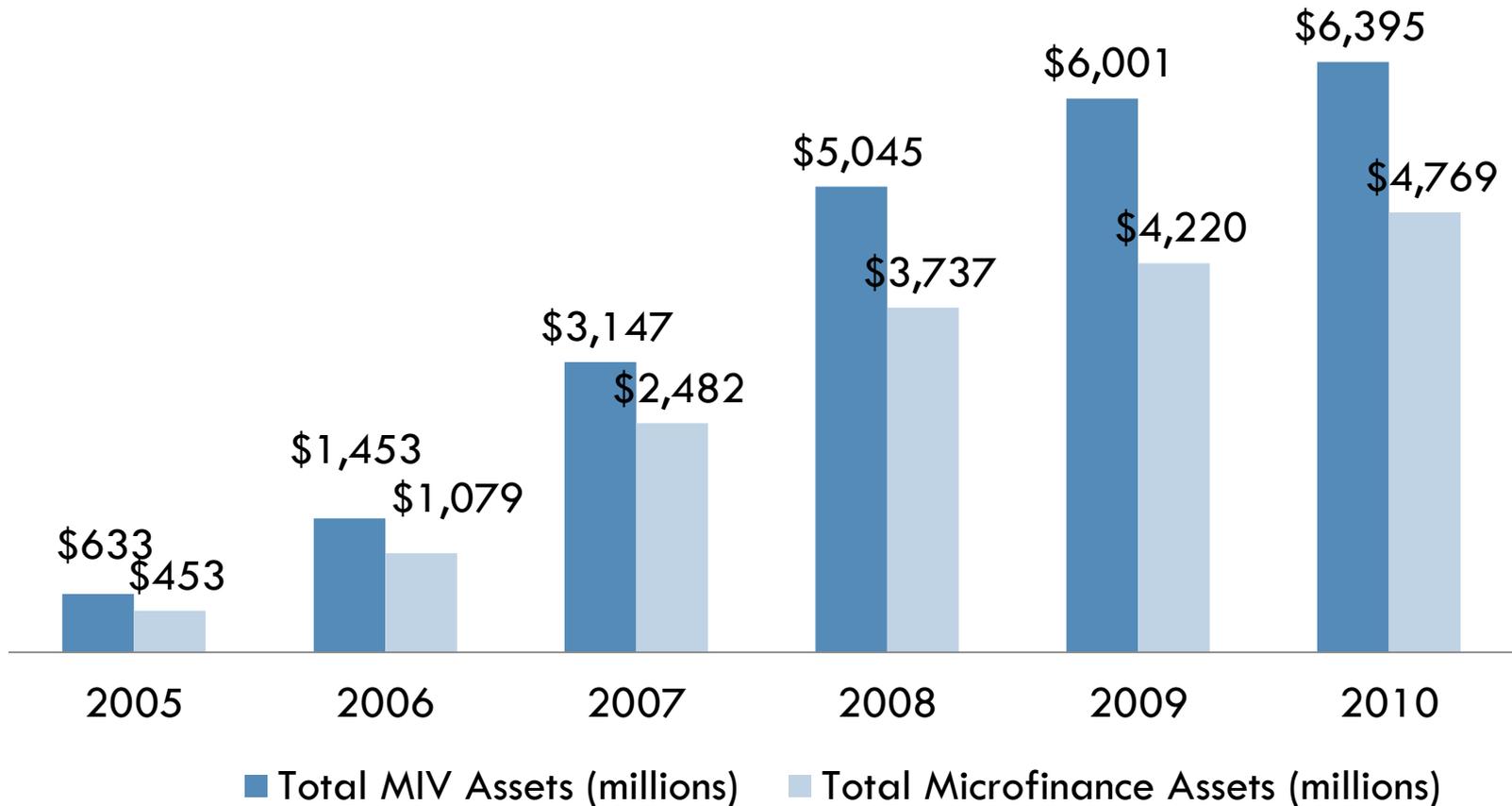
Social Ratings (Stars)

# MIV Landscape

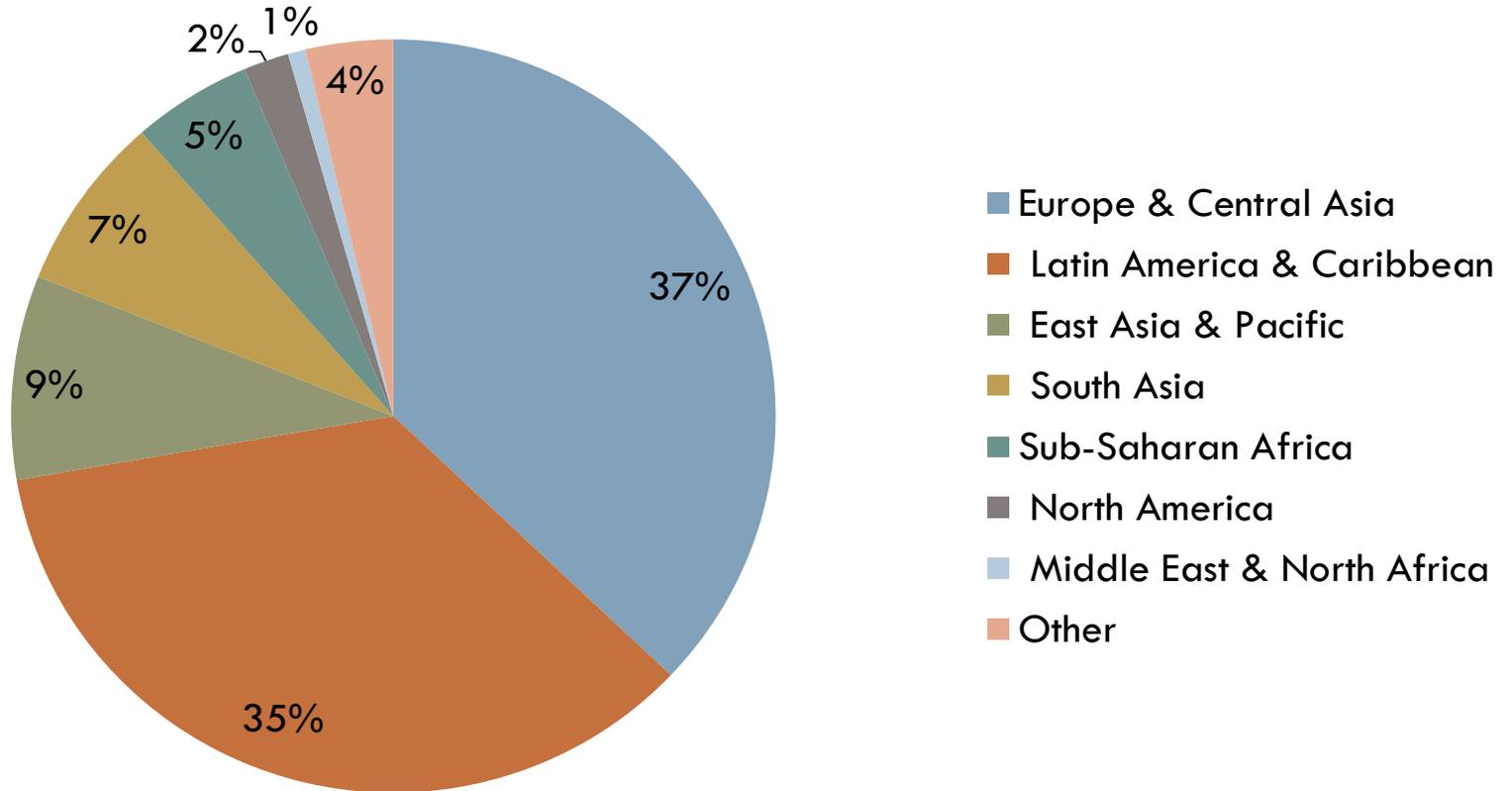


- As of December 2011: 102 MIVs identified globally
- MicroRate (6<sup>th</sup>) Annual MIV Survey – 80 (95% of total assets)
- \$13 billion of total cross border funding
- Private funding to microfinance (foundation, NGOs, investors): \$6.7 billion

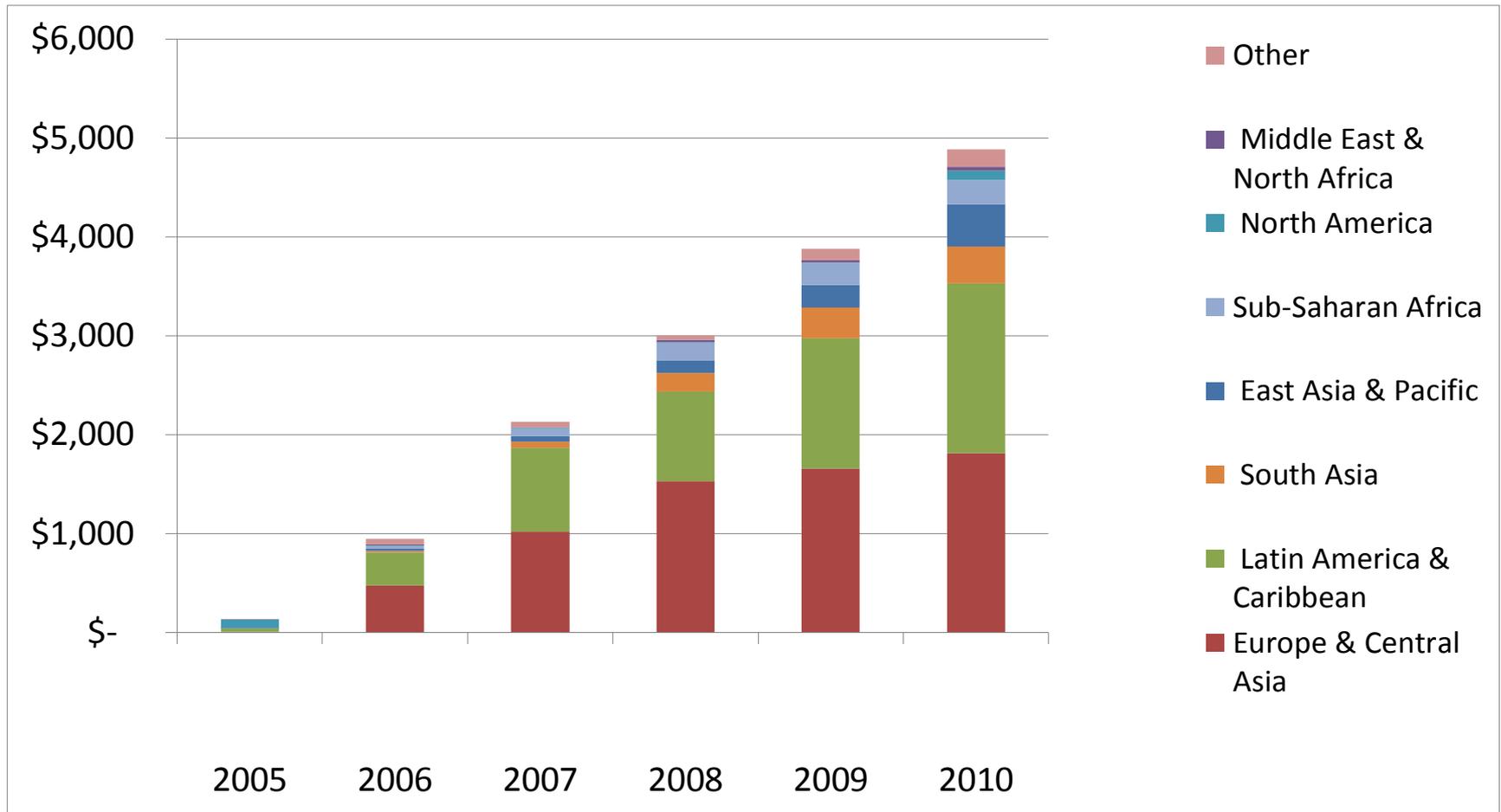
# MIV Asset Growth



# MIV Regional distribution



# MIV Regional distribution



# Fund Comparison

Investor

MIV

MFI

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- Global Partnerships Microfinance Fund 2008, LLC
- Microvest I, LP
- Incofin cvso
- Rural Impulse Fund
- Stichting Hivos-Triodos Fonds
- Stichting Triodos-Doen
- Microvest I, LP
- Grameen Foundation USA
- Global Partnerships Social Investment Fund 2010, LLC
- Triodos Fair Share Fund
- Triodos Microfinance Fund



GRAND DUCHY OF LUXEMBOURG  
Ministry of Foreign Affairs

Directorate for Development Cooperation

- Rural Impulse Fund II S.A.
- Luxembourg Microfinance Development Fund
- Impulse Microfinance Investment Fund
- Alterfin cvba
- BlueOrchard Microfinance Growth Facility
- Dexia Micro-Credit Fund
- ASN-Novib Fund
- Calvert Social Investment Foundation
- Deutsche Bank Micro Credit Development Fund
- MicroCredit Enterprises
- Opportunity International
- Solidarite Internationale pour le Developpement et l'Investissement
- Gawa Microfinance Fund I

# Origin and Purpose



The Luxembourg Government, LuxFLAG, and MicroRate are developing the LUMINIS investor service to provide critical information on Microfinance Investment Vehicles (MIVs) in order to facilitate growth and investment in microfinance.

Because of its long experience in the industry, MicroRate will manage and direct this new investor information service with the support of the Luxembourg Government and the Luxembourg Fund Labeling Agency "LuxFLAG".

The goal of LUMINIS is to create widespread transparency in the universe of MIVs. It will collect and analyze critical performance data, and disseminate it throughout the industry via a web-based platform.

The data and accompanying analyses will allow investors to compare MIVs' relative performance and trends, and ultimately make informed investment decisions.

## Performance

- Targets
- NAV
- Yield
- Indexes
- Exit

## Risk

- Concentration
- W/A Ratings
- FX Exposure
- Regulatory
- Sovereign

## Social

- Target Market
- ESG
- Objectives
- Surveillance
- Effectiveness

## Management

- MF Expertise
- Track Record
- Governance
- Invest Process
- Style/Strategy

# Social Continuum



## Do-no-harm

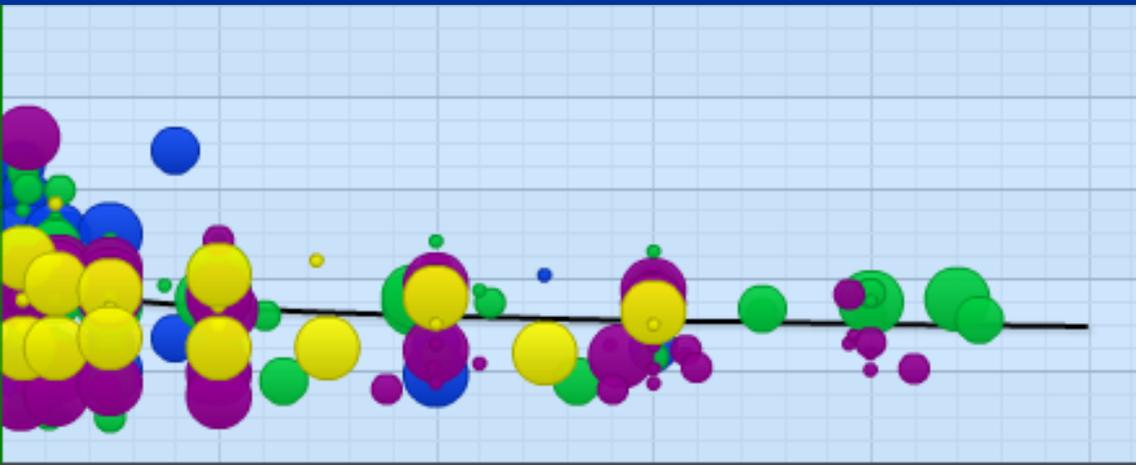
- Corporate Social Responsibility
  - Responsible finance – (balance)
  - Reputation/headline risks – truth in lending
  - Client Protection Principles (SMART Campaign)
  - Principles for Investors in Inclusive Finance (PIIF)

## Do-good

- Outcomes and Impact
  - Who should be doing this?

# **Transparency: Finding our way through the Complete Confusion in Pricing of Micro-credit**

July 2011



# PROPOSITION:

Social Businesses, with Social Investors  
should behave socially.

# ISSUE:

We don't always succeed.

Why not?

What can we do to resolve this?

# Lack of Transparent Pricing

The way we communicate prices to our clients is far from transparent

# Which loan would you pick?

	Zero Interest Loan	Interest and Fees	And Savings	Interest Only
Loan amount:	R1,000	R1,000	R1,000	R1,000
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%

<b>APR</b>	<b>49%</b>	<b>47%</b>	<b>49%</b>	<b>40%</b>
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<b>Transparency Index</b>	<b>0</b>	<b>32</b>	<b>25</b>	<b>100</b>
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How did microfinance end up with  
non-transparent pricing?

# The Downward Spiral

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

# The Downward Spiral

- All MFIs have transparent prices
- MFI 1:
  - Interest: 2.5% decl.
- MFI 2:
  - Interest: 3.0% decl.

# The Downward Spiral

- All MFIs have transparent prices
- **Some MFIs shift to flat interest**
- MFI 1:
  - Interest: 2.5% decl.
- MFI 2:
  - Interest: **2.0% flat**

# The Downward Spiral

- All MFIs have transparent prices
- Some MFIs shift to flat interest
- **All MFIs shift to non-transparent pricing**
- MFI 1:
  - Interest: **1.75% flat**
- MFI 2:
  - Interest: 2.0% flat

# The Downward Spiral

- All MFIs have transparent prices
- Some MFIs shift to flat interest
- **All MFIs shift to non-transparent pricing.. And it continues**
- MFI 1:
  - Interest: 1.75% flat
- MFI 2:
  - Interest: **1.6% flat, 2% upfront fee**

# The Downward Spiral

- All MFIs have transparent prices
  - Some MFIs shift to flat interest
  - All MFIs shift to non-transparent pricing
  - **Consumers struggle to choose.... Which would YOU choose?**
- MFI 1:
    - Interest: 1.75% flat
  - MFI 2:
    - Interest: 1.6% flat, 2% upfront fee

# The Downward Spiral

- All MFIs have transparent prices
- Some MFIs shift to flat interest
- All MFIs shift to non-transparent pricing
- **Consumers struggle to choose... Because the prices are far from clear**
- MFI 1:
  - Interest: 1.75% flat
  - **APR: 37%**
- MFI 2:
  - Interest: 1.6% flat, 2% upfront fee
  - **APR: 57%**

# The Downward Spiral

- All MFIs have transparent prices
- Some MFIs shift to flat interest
- All MFIs shift to non-transparent pricing
- Consumers struggle to choose
- **Profits are correlated to price**
- MFI 1:
  - Interest: 1.75% flat
  - APR: 37%
  - **ROE: 10%**
- MFI 2:
  - Interest: 1.6% flat, 2% upfront fee
  - APR: 57%
  - **ROE: 40%**

# The Downward Spiral

- 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
- Transparency, and particularly pricing transparency, is a key element to correct this serious problem in the microfinance industry

The Microfinance Industry is now  
working in concert to reverse that  
downward spiral

# Advances in Promoting Responsible Practice

- MFTransparency
- SMART Campaign
- SPTF
- Principles for Responsible Investing
- Seal of Excellence

# Rapid Progress in Transparency

(Results of our first two years)

- MFT currently working in 28 countries (adding 1 more each month)
  - 400 Institutions
  - 2,000 different loan products
  - 55 million clients
  - US\$15 billion in outstanding portfolio
- Microfinance is the first industry of any kind in the world to practice global, voluntary disclosure of true pricing.

# Challenge: We need to do smarter analysis

Our limited analysis of pricing in microfinance focuses on the wrong information, e.g.,

- Average portfolio yield
- Operating cost ratio benchmarks

## Are Microcredit Interest Rates Excessive?

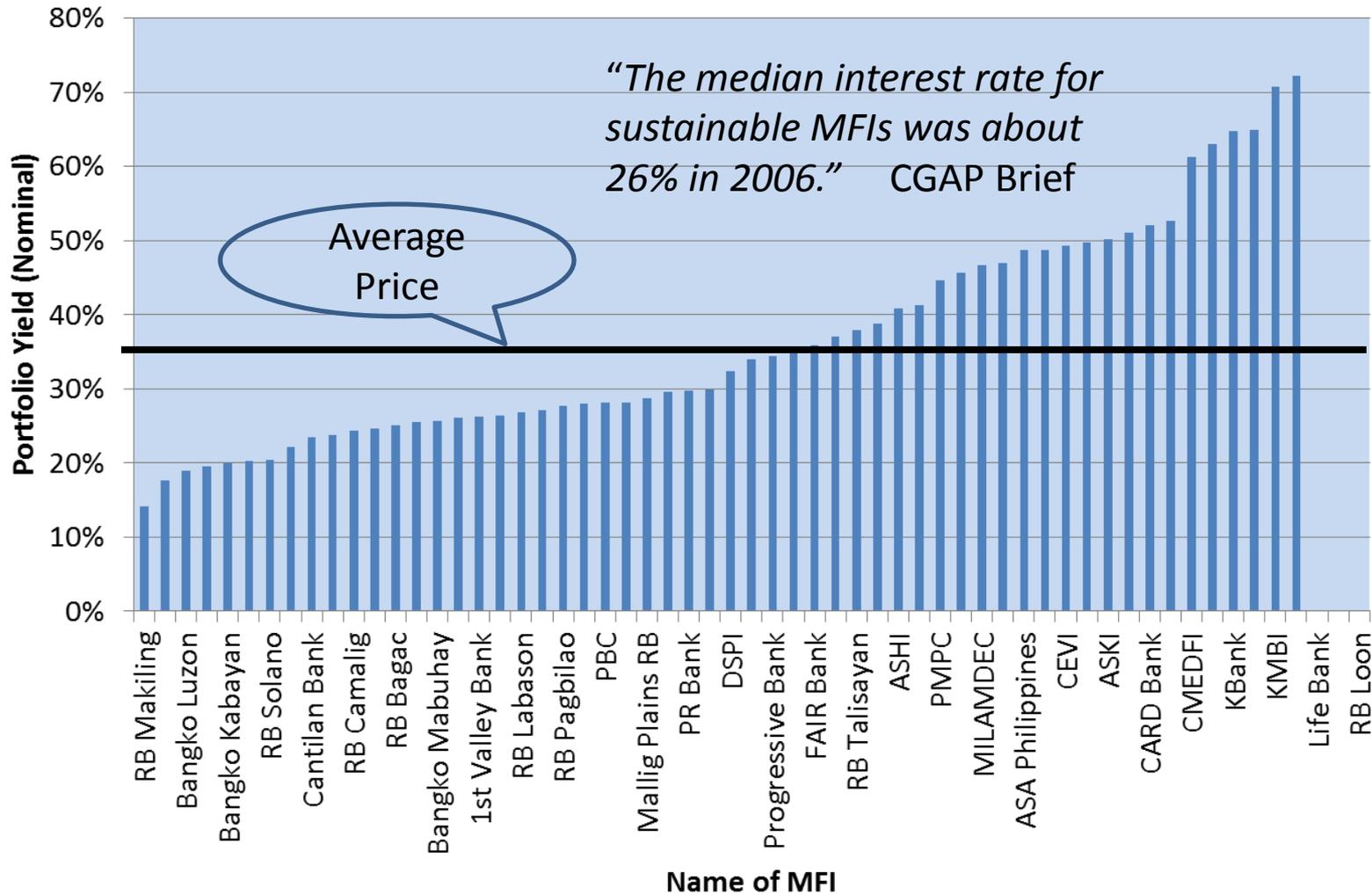
Over the past two decades, institutions that make microloans to low-income borrowers in developing and transition economies have focused increasingly on making their operations financially sustainable by charging interest rates that are high enough to cover all their costs. They argue that doing so will best ensure the permanence and expansion of the services they provide. Sustainable (i.e., profitable) microfinance providers can continue to serve their clients without needing ongoing infusions of subsidies, and can fund exponential growth of services for new clients by tapping commercial sources, including deposits from the public.

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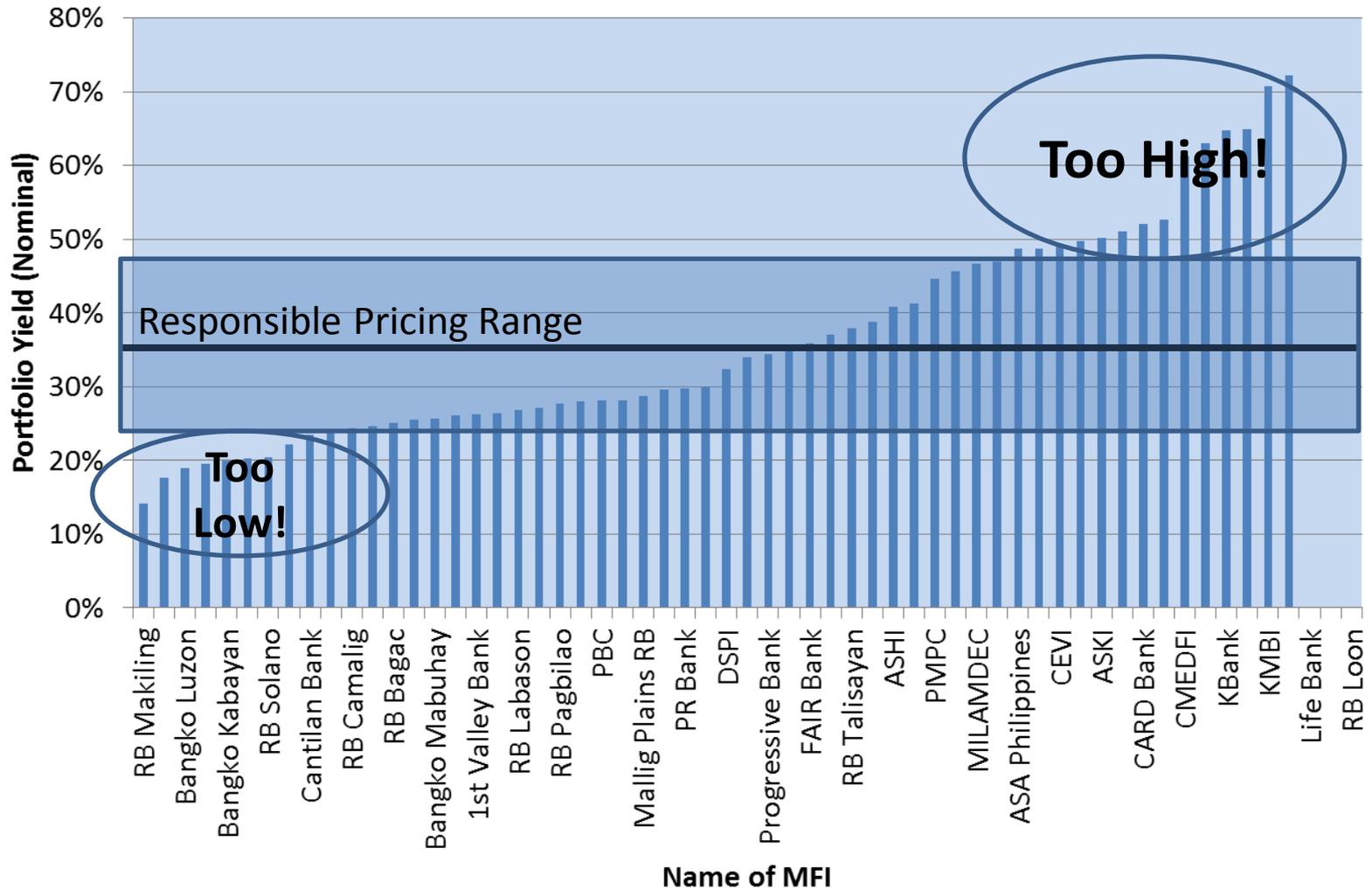
The problem is that administrative costs are inevitably higher for tiny microlending than for normal bank lending. For instance, lending

Nevertheless, accepting the importance of financial sustainability does not end the discussion of interest rates. An interest charge represents

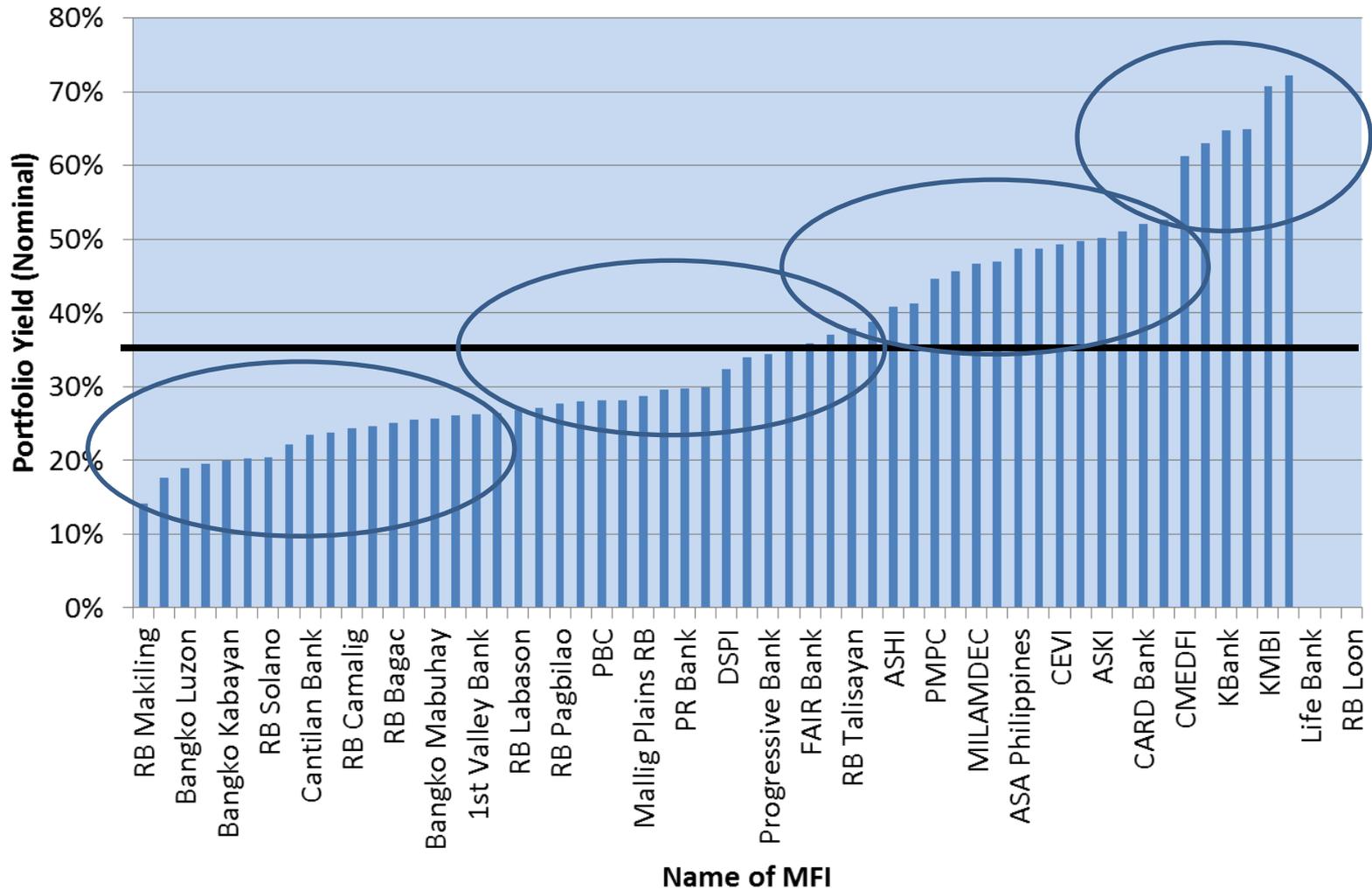
## Portfolio Yield by MFI Philippines, 59 MFIs



## Portfolio Yield by MFI Philippines, 59 MFIs

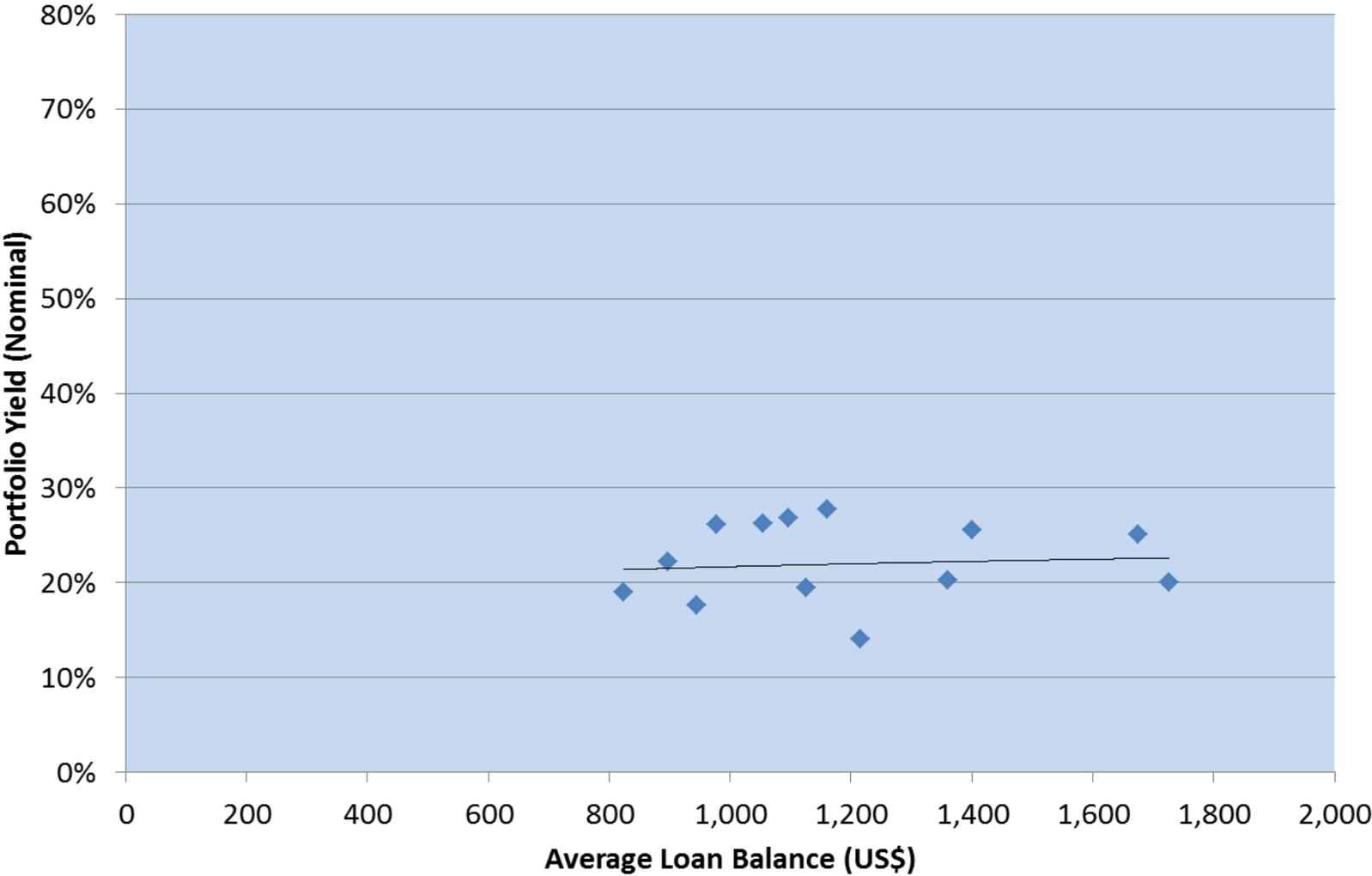


## Portfolio Yield by MFI Philippines, 59 MFIs



# Portfolio Yield vs Average Loan Balance

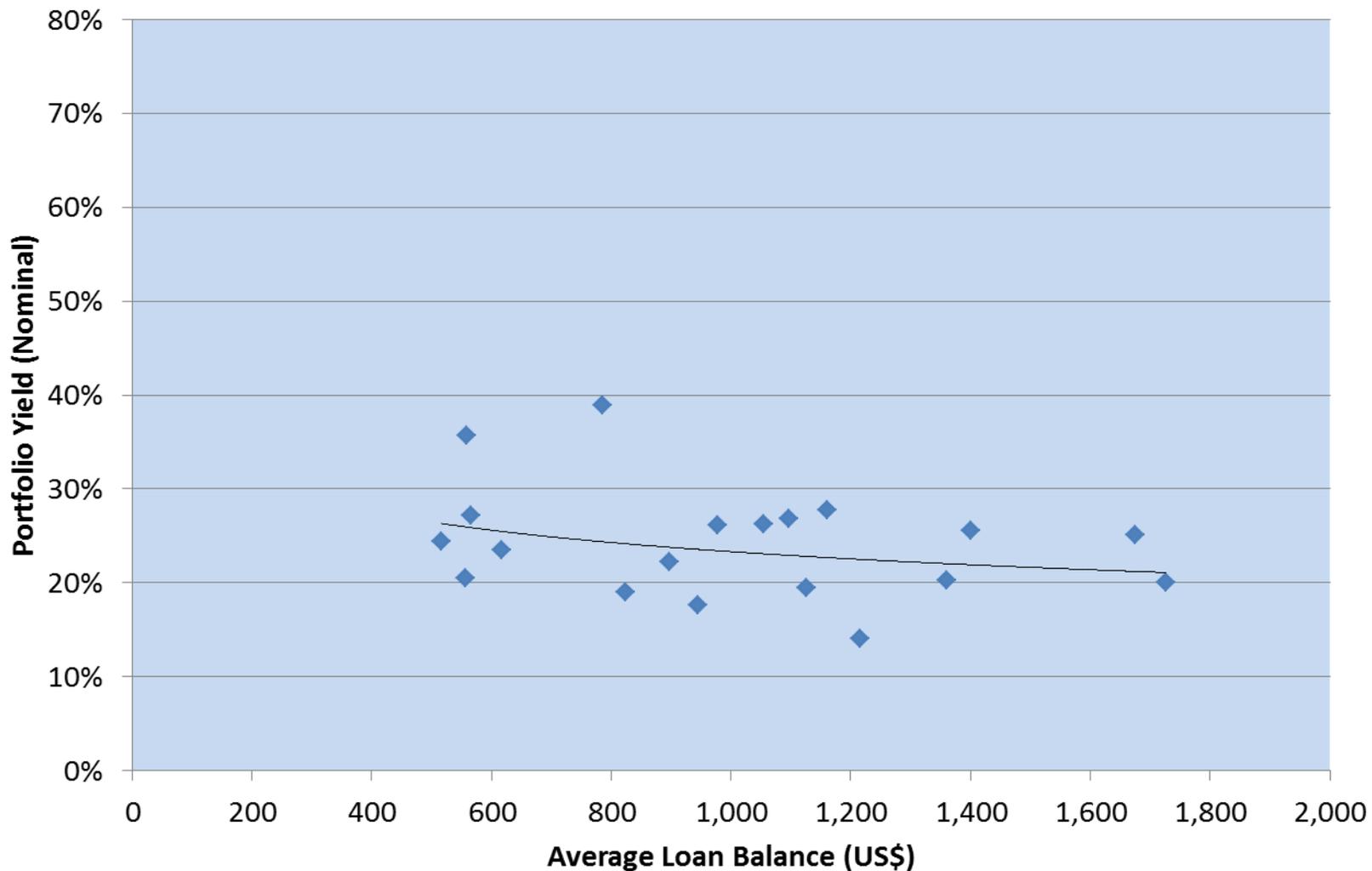
## Philippines, 14 MFIs



◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

## Portfolio Yield vs Average Loan Balance Philippines, 20 MFIs

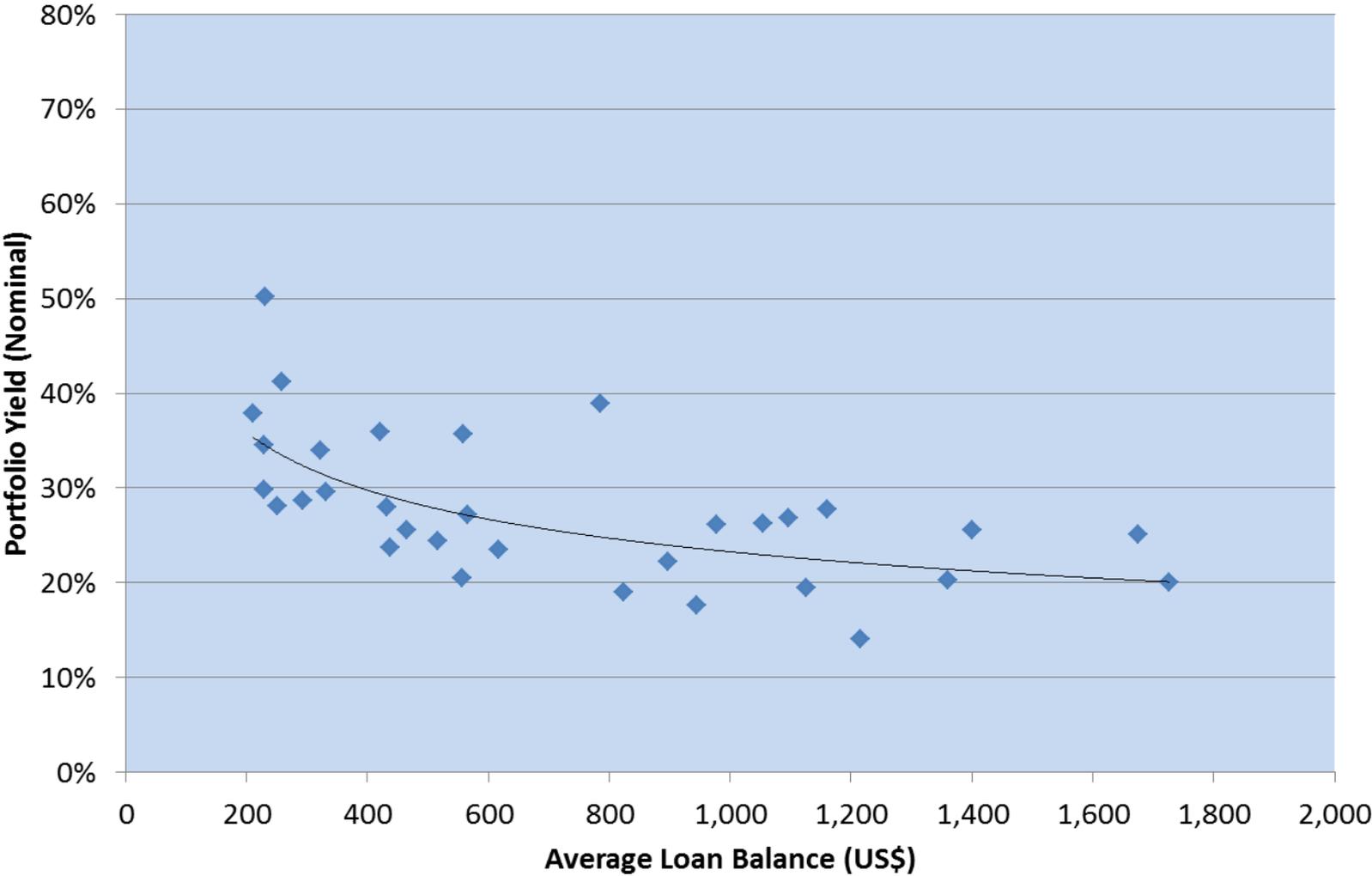


◆ Portfolio Yield vs Average Loan Balance

— Power (Portfolio Yield vs Average Loan Balance)

# Portfolio Yield vs Average Loan Balance

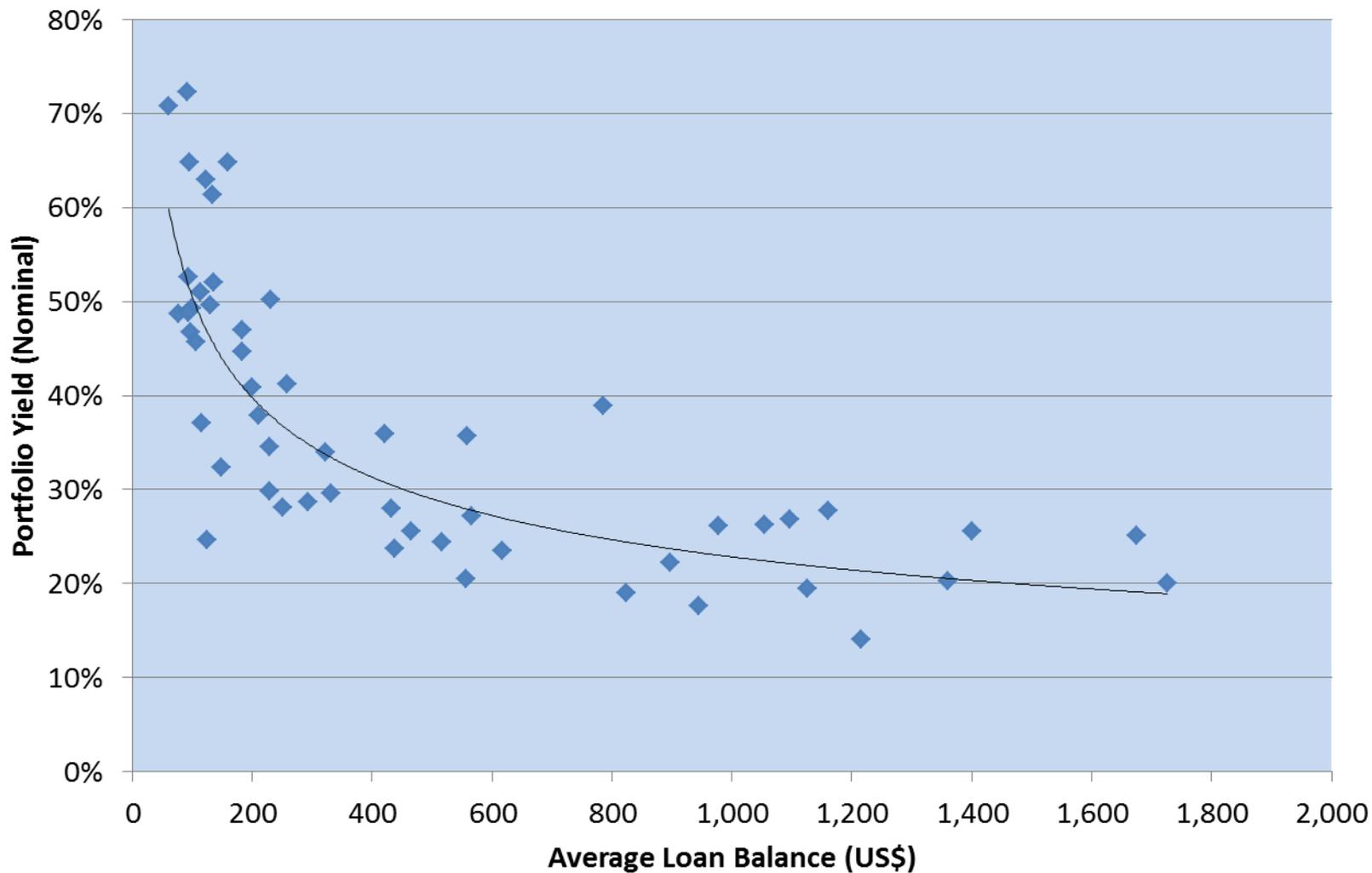
## Philippines, 34 MFIs



◆ Portfolio Yield vs Average Loan Balance      — Power (Portfolio Yield vs Average Loan Balance)

# Portfolio Yield vs Average Loan Balance

## Philippines, 59 MFIs

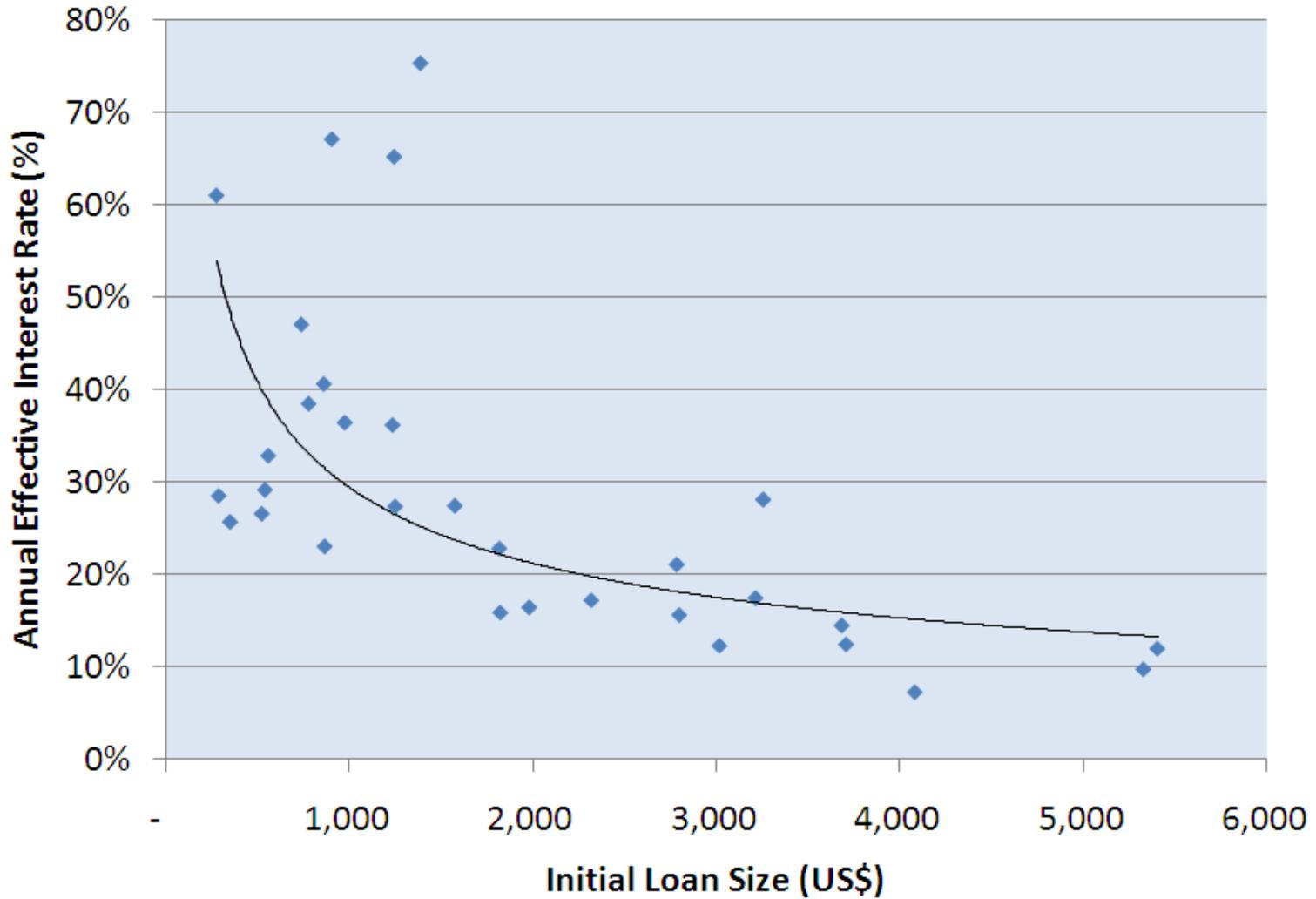


◆ Portfolio Yield vs Average Loan Balance

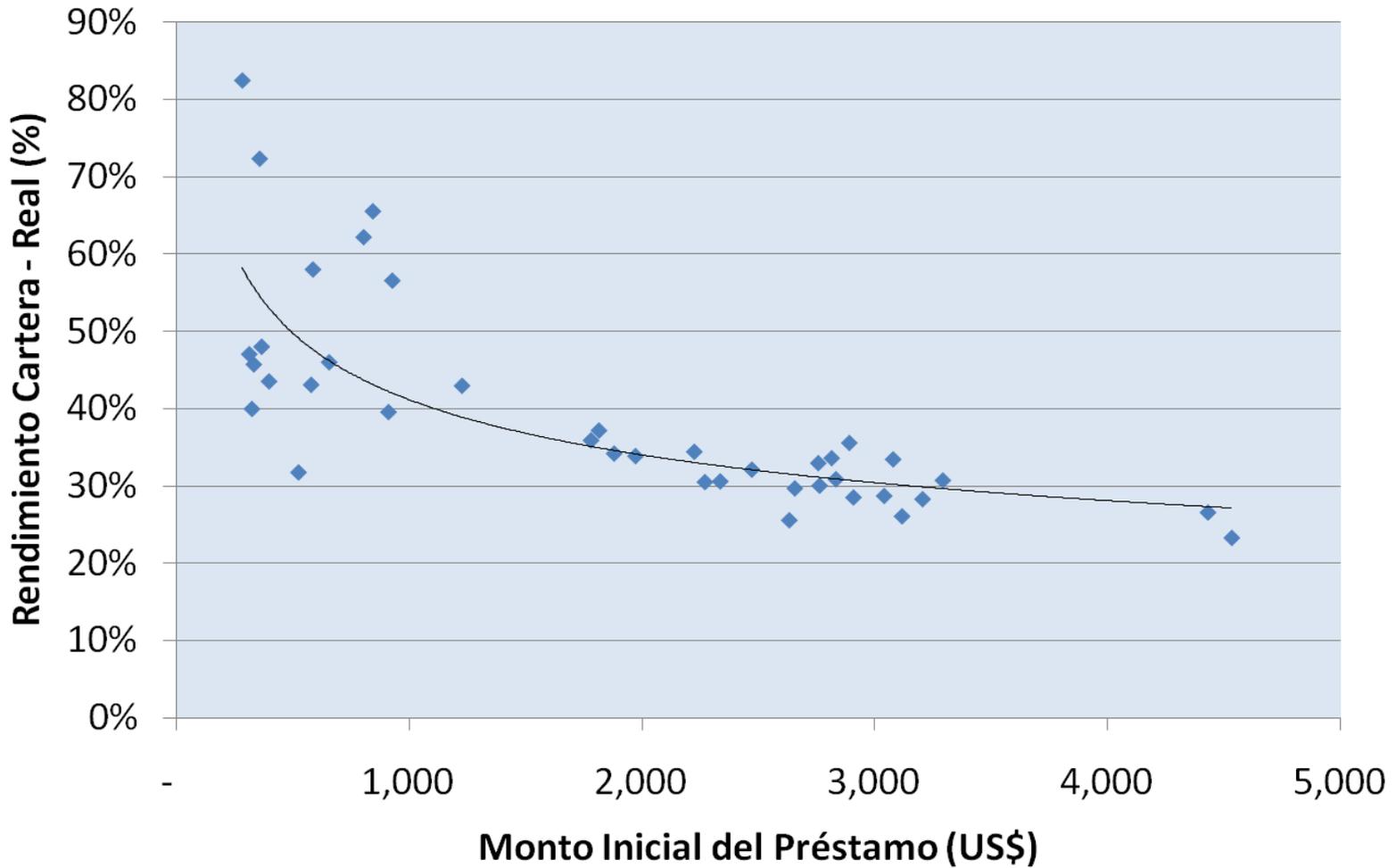
— Power (Portfolio Yield vs Average Loan Balance)

Is there a curve in other countries?

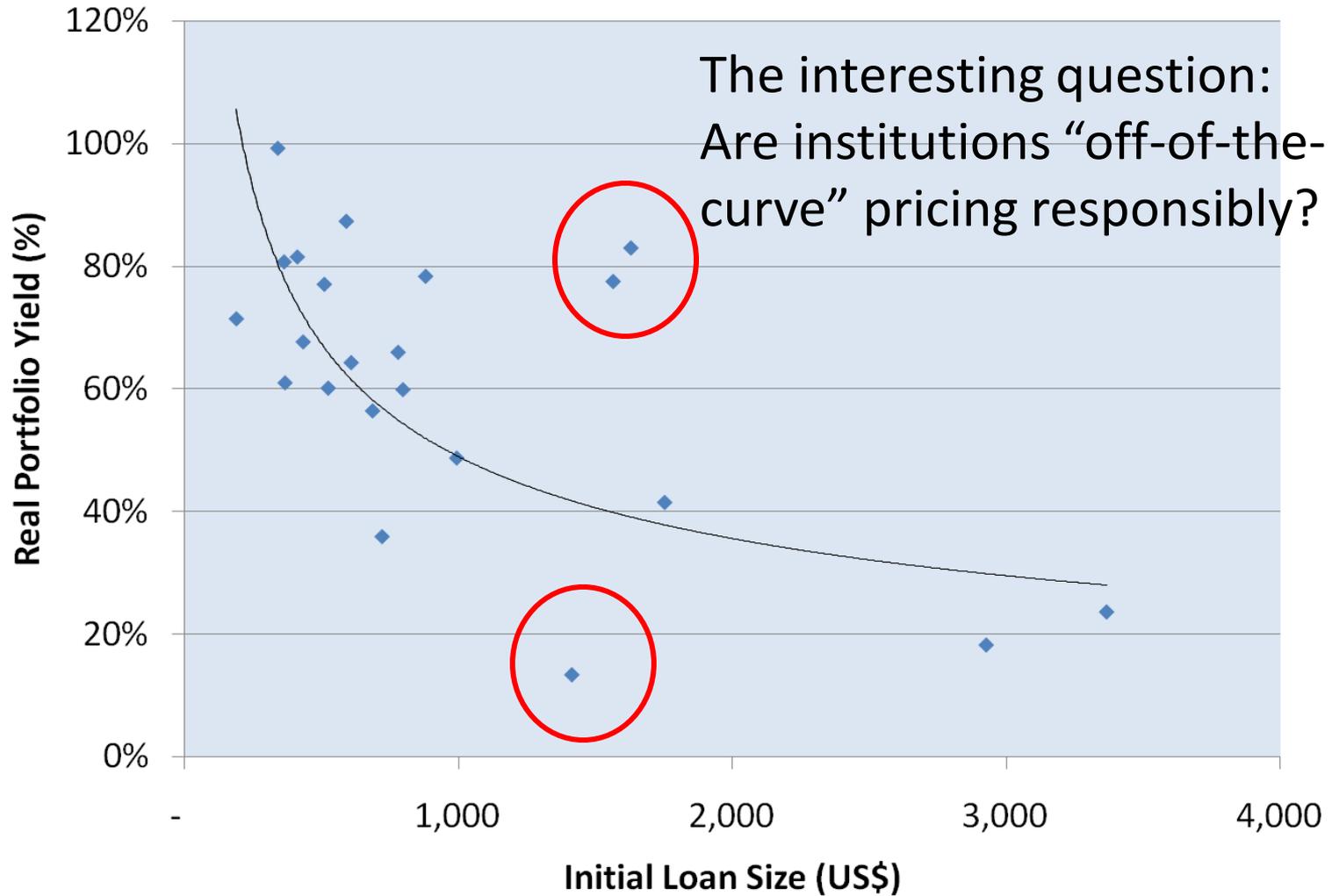
## Loan Size and Interest Rate (31 MFIs in Ecuador)



## Monto Prestado y Rendimiento de Cartera (Real) (39 MFIs en Peru)



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

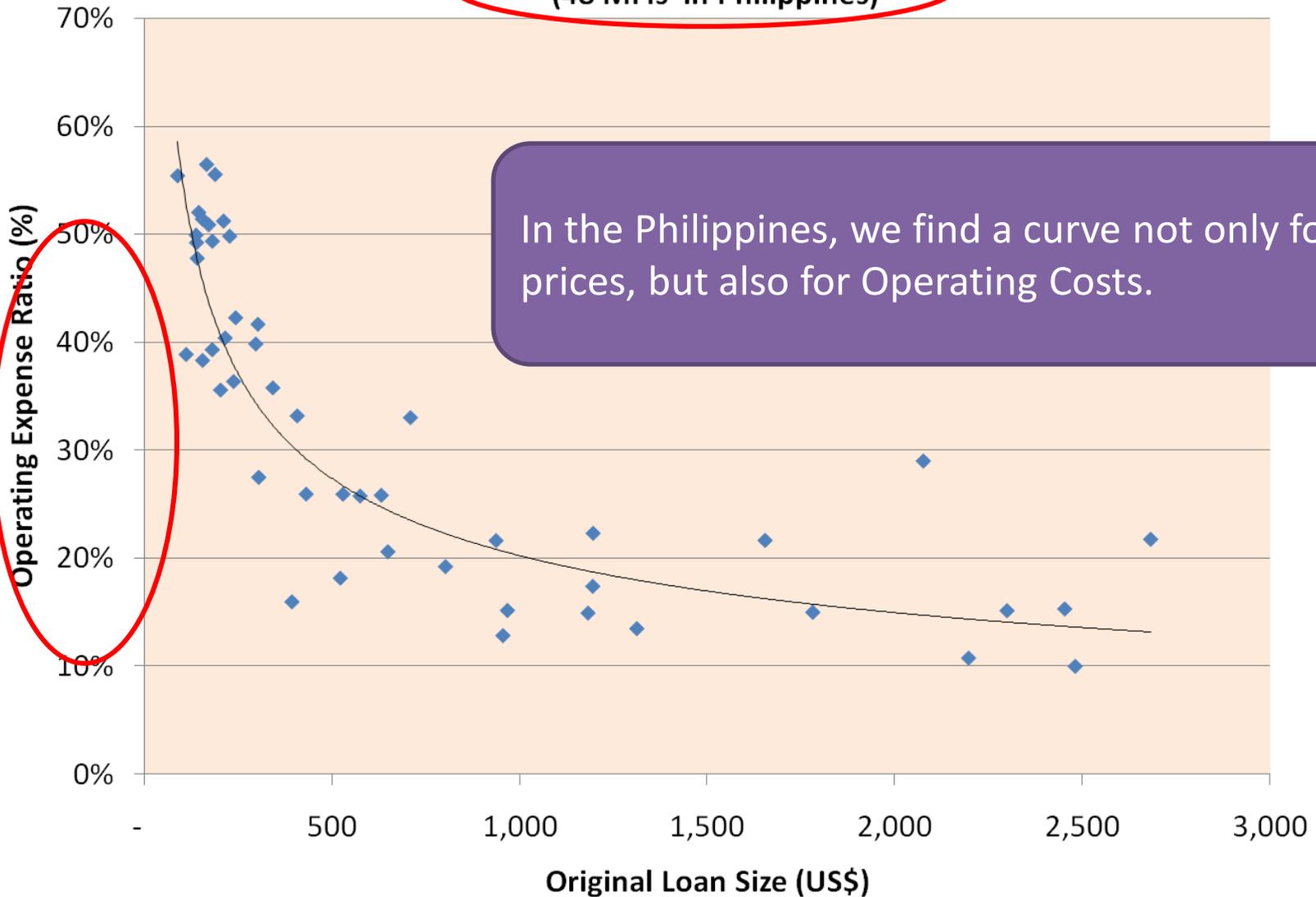


## Possible Conclusion:

The poorer the client, the more we exploit her by charging higher prices

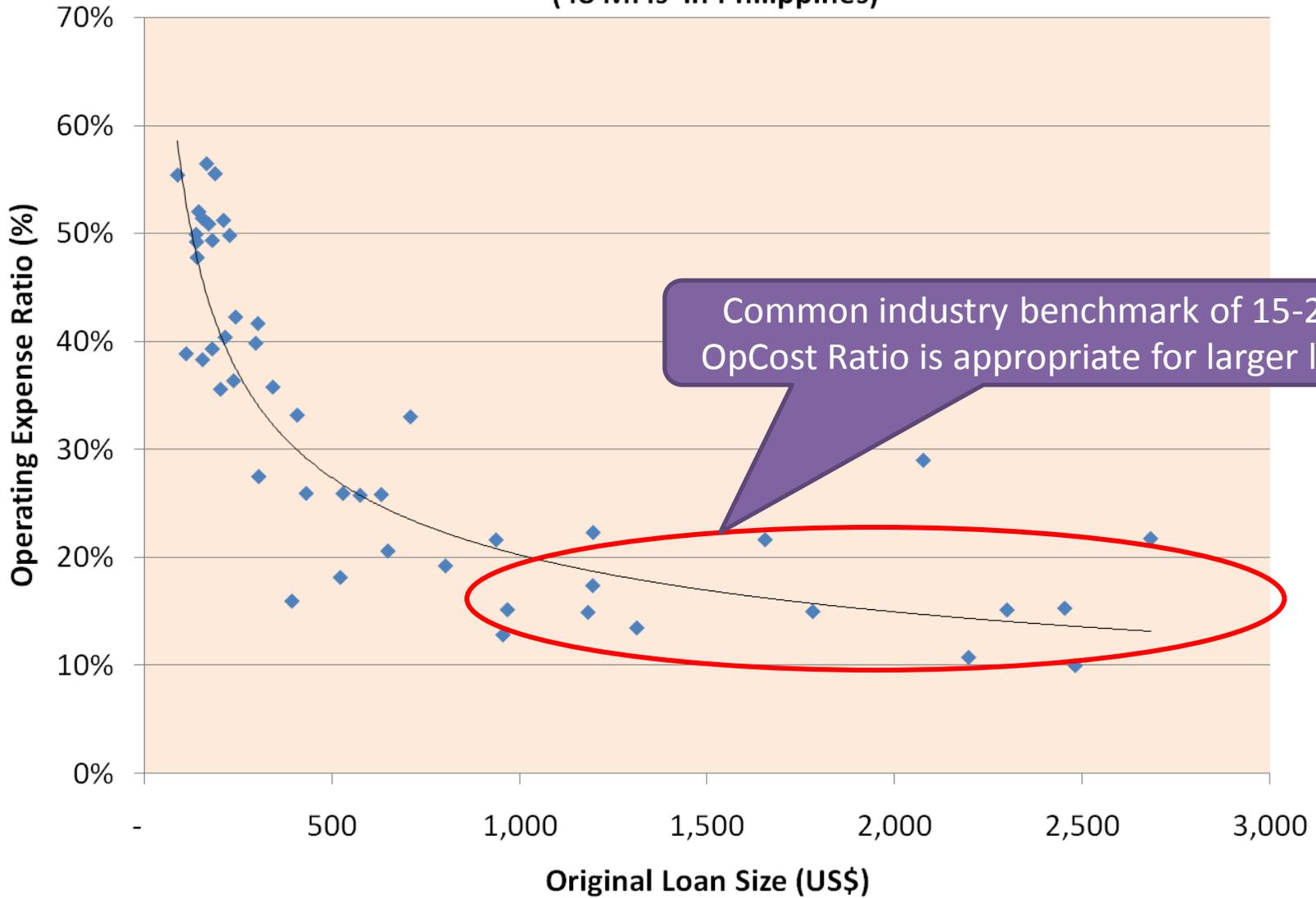


# Loan Size and Op Exp/Port % (48 MFIs in Philippines)

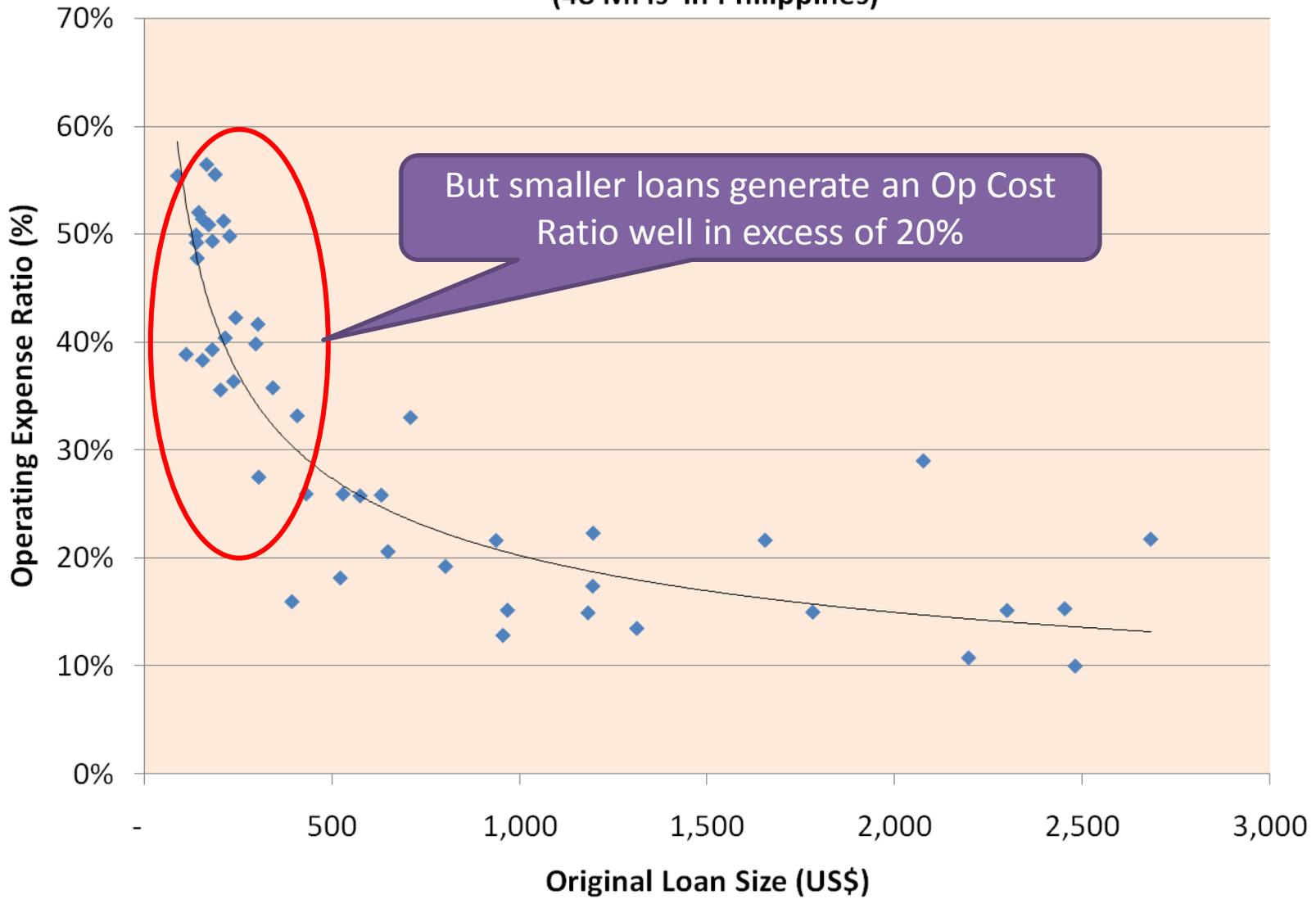


In the Philippines, we find a curve not only for prices, but also for Operating Costs.

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



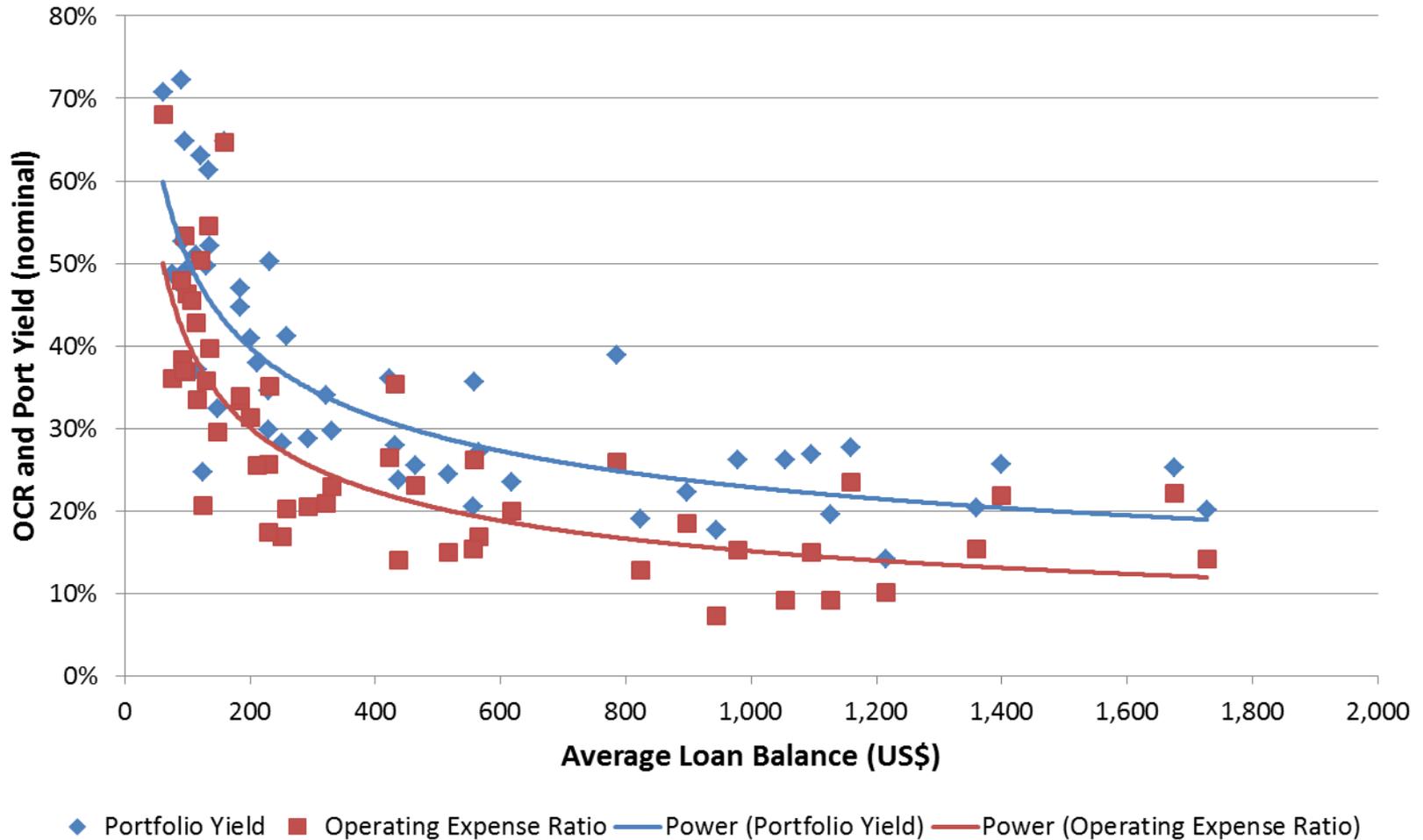
# Loan Size and Op Exp/Port % (48 MFIs in Philippines)



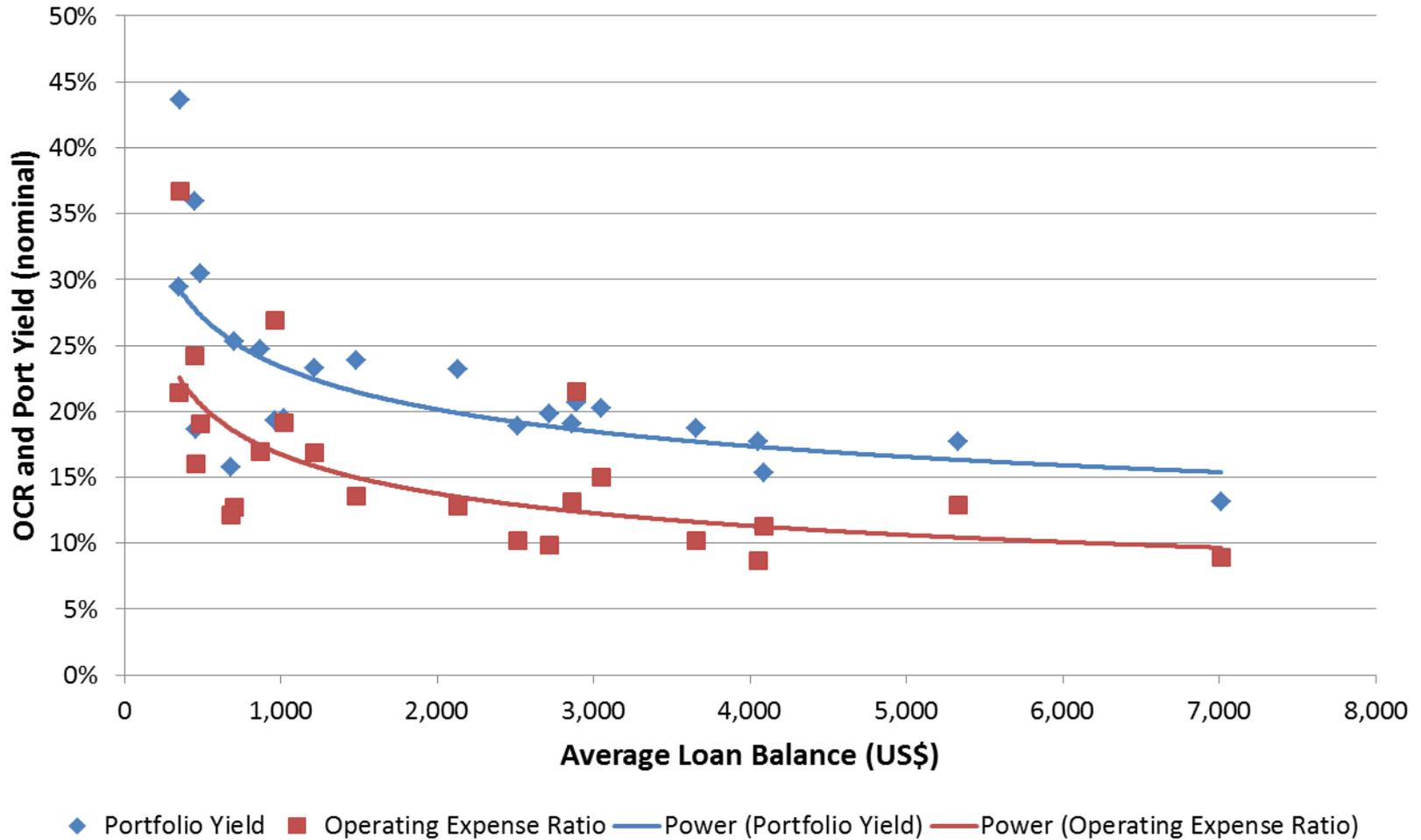


# Comparison of the Cost Curve and the Price Curve

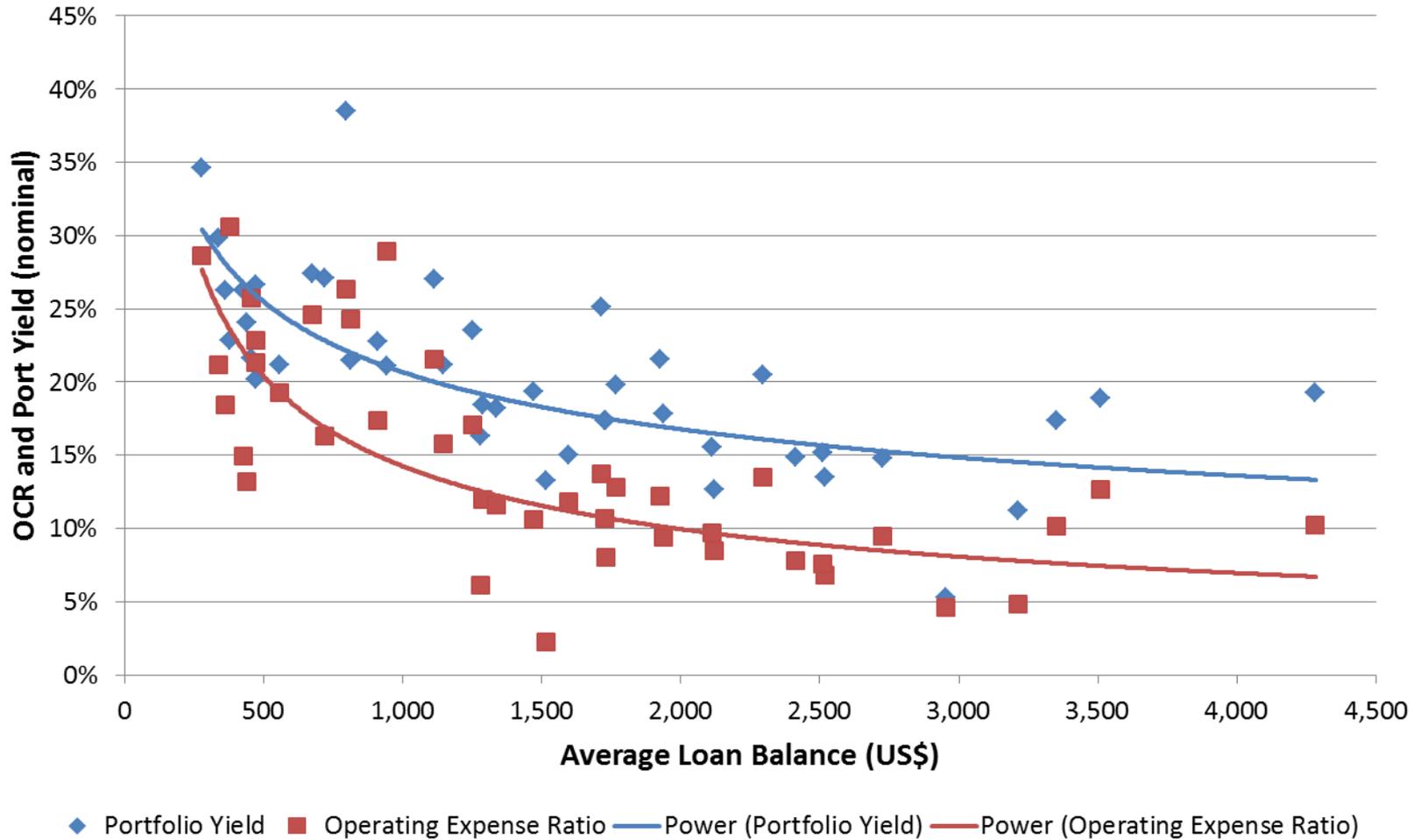
## Portfolio Yield & OER vs Average Loan Balance Philippines, 59 MFIs



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



## Portfolio Yield & OER vs Average Loan Balance Ecuador, 43 MFIs

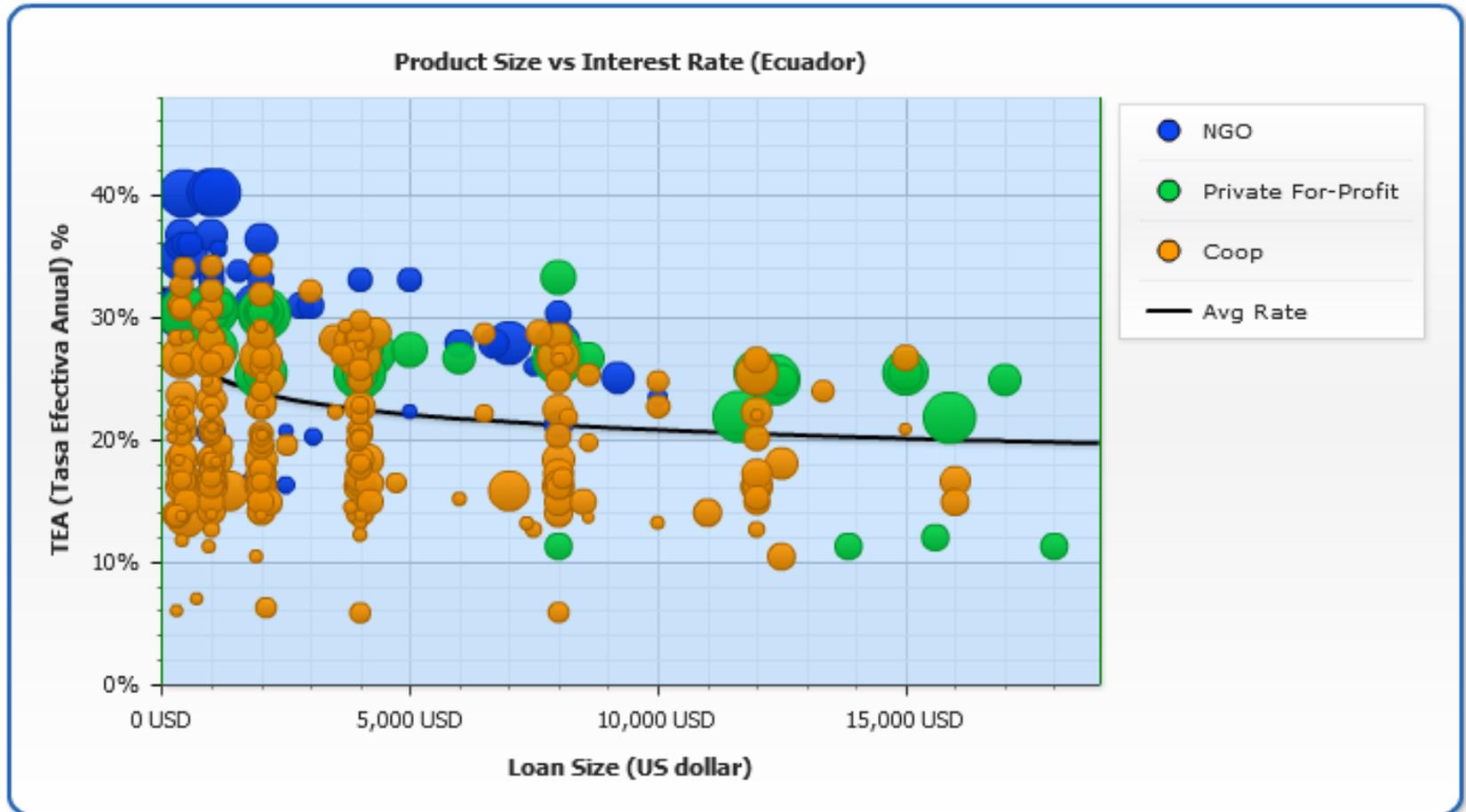


# What is Transparent Pricing?

The pricing, terms, and conditions of financial products will be adequately disclosed to the clients in a clear manner that allows both

- Accurate understanding of prices, and
- Ability to compare different products.

# Ecuador Data



# Results of Non-Transparent Pricing

MFIs do not compete on price but on other factors

Prices therefore can and do vary dramatically

Some MFIs push prices higher to maximize profits

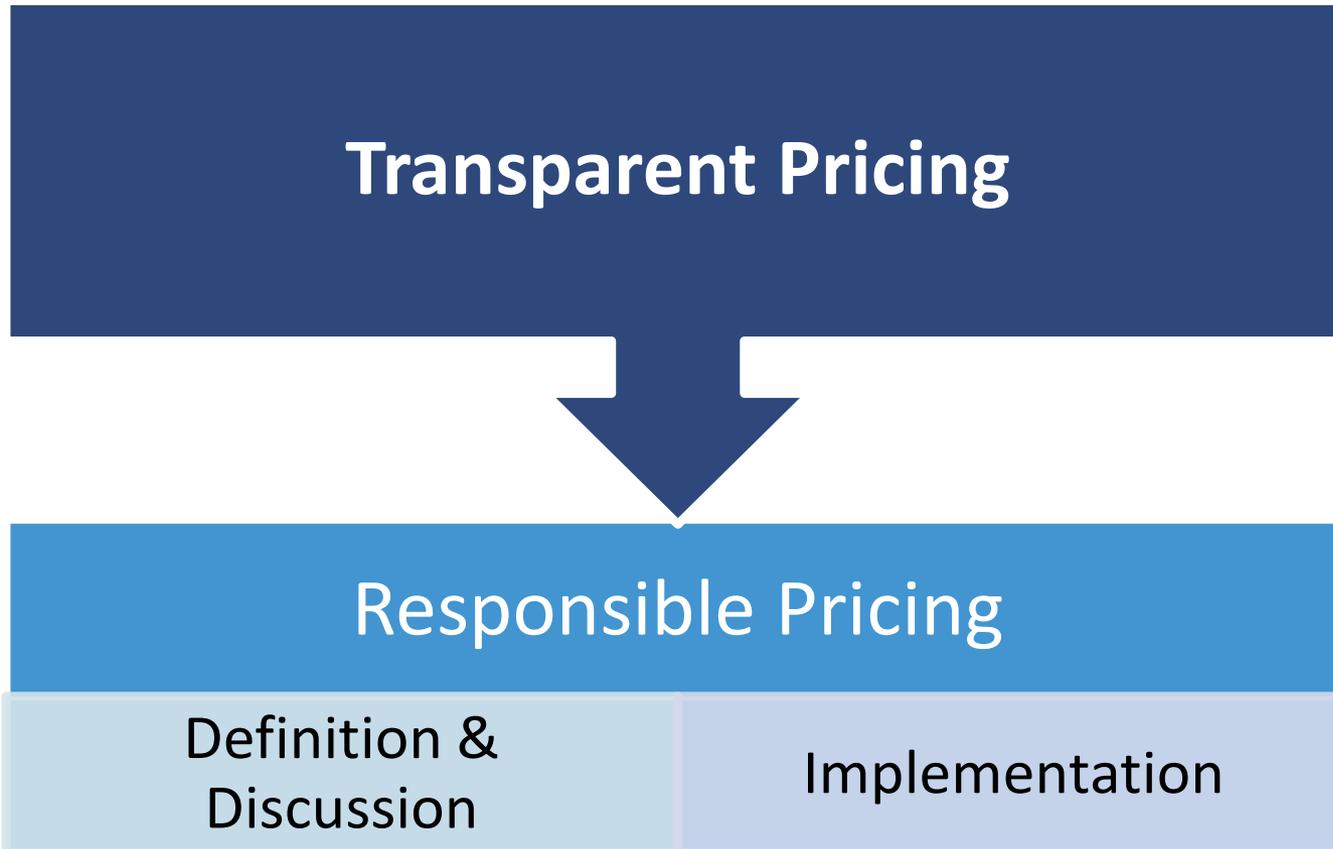


Consumers are often told a much lower price than reality

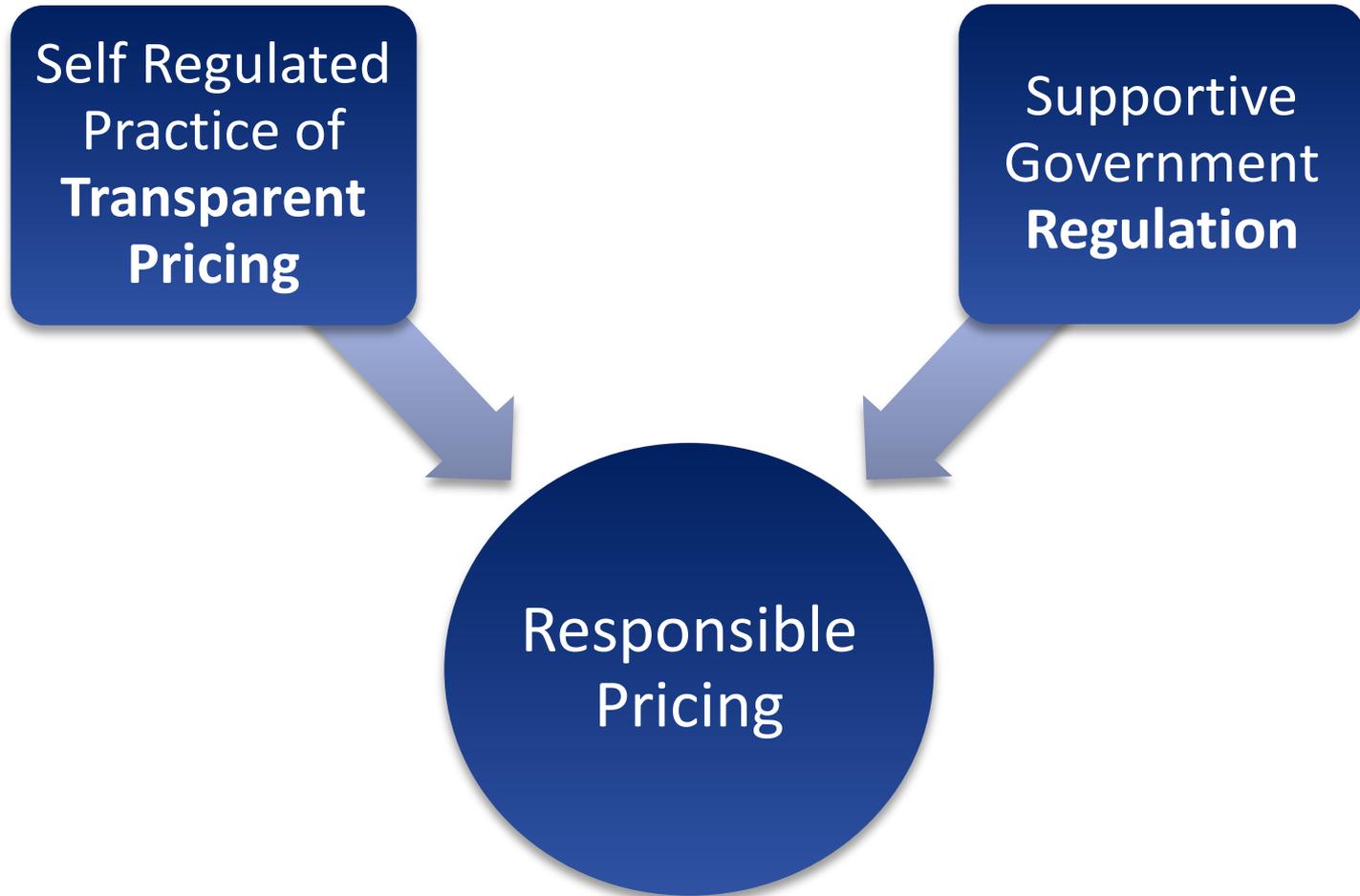
Consumers buy more expensive loans

Consumers go into more debt than they should

# Transparency Must Come First



# Combined Approach



# What does transparency mean for responsible pricing?

No transparency = less competition



Less competition = wider range in prices



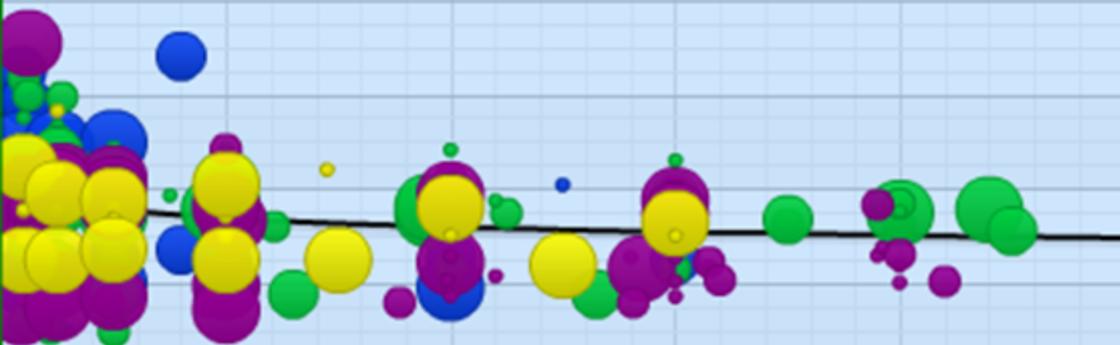
We improve transparency and price competition...



**Competitive prices = Responsible prices**



# Promoting Transparent Pricing in the Microfinance Industry





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**July 20, 2011**



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