CIRCLE

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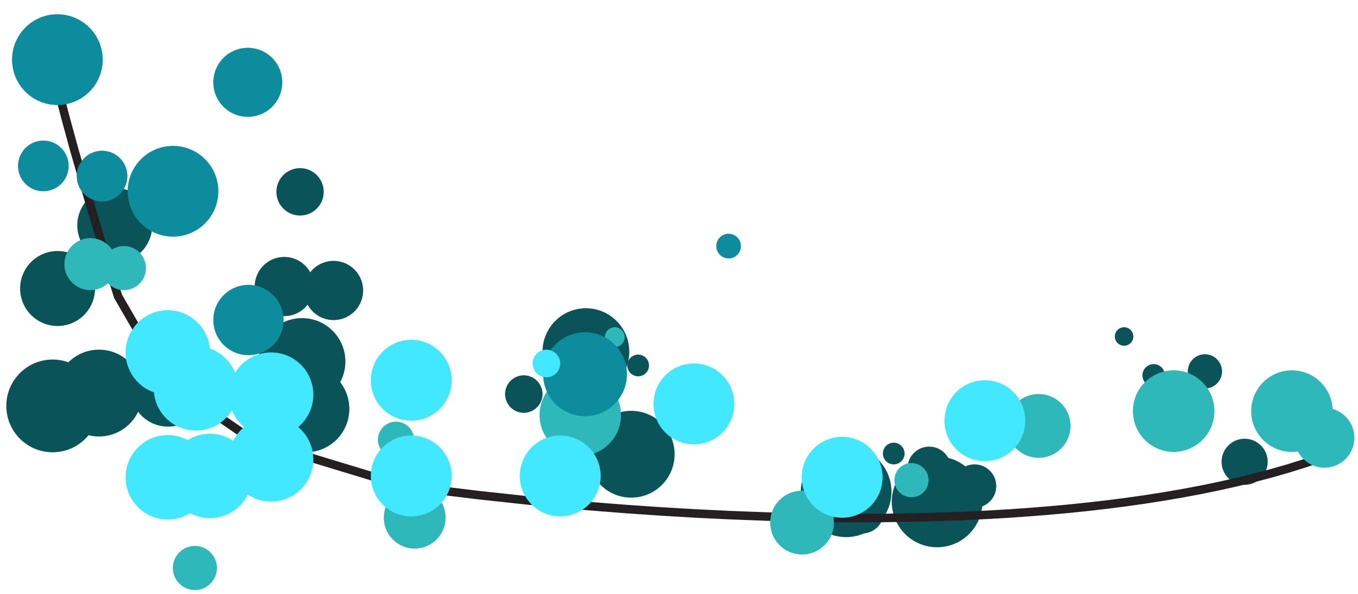

PRICING TRANSPARENCY IN MICROFINANCE

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Over the past decade the microfinance industry has experienced rapid growth, in the Philippines as well as internationally, both in terms of outreach and innovation in the products and services offered. While the industry has long been praised for its efforts to promote economic empowerment, more recently it has also been criticized for its increasingly commercialized and profit-oriented operations.

At this critical point, industry players need to work together to convey their commitment to the social mission of microfinance and to ensure that conditions are in place for a dynamic and healthy industry. This can be achieved through consumer protection, transparency of financial information and dialogue among different stakeholders. It is in this context that MicroFinance Transparency (MFTransparency) was launched in July 2008 at the Microcredit Summit in Bali, Indonesia.

THE MFTRANSPARENCY APPROACH

Led by CEO and President Chuck Waterfield, MFTransparency aims to promote transparency by facilitating microfinance pricing disclosure, offering policy advisory services and developing training and education materials for all market stakeholders. MFTransparency collects and disseminates microloan pricing data in a clear and consistent fashion, so that all microfinance stakeholders can work with a full understanding of the true prices paid by borrowers. MFTransparency also engages in consultations and dialogues with regulators and policymakers to support their process of developing policy for pricing disclosure and client protection.

MFTransparency piloted this multi-pronged approach in Peru and Bosnia in March 2009. Since then, it has grown its operations to nearly 30 countries. MFTransparency works country by country, partnering with local networks and associations to better reach individual financial institutions and address the unique characteristics of the market. MFTransparency publishes pricing data for the large majority of the market all at the same time, creating an enabling environment for transparency so that no individual institution is disadvantaged by sharing their prices.

WHAT IS PRICING TRANSPARENCY?

Transparent pricing means that all charges, terms and conditions of financial products are adequately disclosed to clients in a clear manner that allows both accurate understanding of prices and comparison among different products[5]. Unfortunately, the manner in which many financial institutions present their micro-credit prices to clients can be extremely confusing and is often far from transparent. For example, if given the following options, a client might have a difficult time determining which is the cheapest loan:

	A	B	C
Loan Amount	1,000	1,000	1,000
Loan Term	10 weeks	10 weeks	10 weeks
Interest Rate	0%	15% "flat"	40% declining
Service Fee	5%	2%	0%

[5] *Smart Campaign, 2010.*

Comparing interest rates alone is not enough. There are other factors which affect the true price of a loan, such as charging interest based on flat or declining balance, fees and surcharges, mandatory insurance premiums, savings requirements and the loan term. To truly understand the cost of a loan, not only the total amount paid in interest and fees, the cash flow of the borrower throughout the loan term must be taken into account.

MFTransparency advocates the use of the Annual Percentage Rate (APR) to communicate pricing. APR is defined as the declining balance interest rate equivalent to the true cost of the loan, including all interest payments and mandatory fees. Using the APR captures all relevant components of pricing, including cash flow, and enables accurate comparison between loans. Computing the APR for the above products shows that Product C has the lowest cost, even though a nominal annual interest rate of 40% may sound the highest to the client.

	A	B	C
APR	49%	47%	40%

MFTransparency has developed a Calculating Transparent Prices Tool that can be used to calculate the APR of any loan. This tool allows users to input different loan terms to see how these will affect the APR and also Effective Interest Rate (EIR), total cost of credit, cash flow and repayment schedule of the loan product. It is an interactive tool that illustrates the different factors that affect pricing. This is a useful tool for financial institutions considering restructuring the prices of their credit products or that simply want to know the true prices of their loans. The tool is available free of charge and can be downloaded from the MFTransparency website (www.mftransparency.org).

WHAT ARE THE BENEFITS?

All members of the microfinance industry stand to gain from pricing transparency. Transparency corrects a serious market imperfection, enabling fair competition between service providers and allowing borrowers to make informed decisions about the products available to them. Moreover, it provides other industry stakeholders with a database of pricing information that can be used to advocate for appropriate regulation and policies.

Moving to a more transparent market requires education and effective communication. We need to make efforts as an industry to educate ourselves as well as microfinance clients and the general public. This means training MFI staff, especially loan officers, so that they can adequately explain pricing components to their clients. The public, especially media, politicians and regulatory bodies, should also be educated so that they understand how pricing works in the microfinance industry. An underlying philosophy of MFTransparency's approach is that information must be accompanied by education, and we work to publish our pricing data along with analysis and contextual information as well as a range of educational materials.

MFTransparency's work supports the second and third Client Protection Principles of the Smart Campaign—transparency and responsible pricing. We also contribute pricing data to the social performance reports done by the MIX Market. Transparency is a prerequisite of all efforts towards social performance management and responsible practice, and MFTransparency provides a foundation of information that the industry can build on towards these objectives.

"It is our duty to clearly communicate true prices to our clients." (Muhammad Yunus, Grameen Bank) MFTransparency is working to provide an enabling environment for microfinance institutions to fulfill this duty to ultimately achieve well-functioning markets, healthy competition and better services for millions of poor people.

For more information, tools and resources on transparent pricing, visit www.mftransparency.org.

LOOKING INTO RISK MANAGEMENT WITH A SOCIAL LENS

A risk is an exposure to the chance of loss. Risks are not inherently bad. Sometimes, it is necessary to take risks to accomplish worthy and meaningful goals. Risk management, or the process of taking calculated risks, reduces the likelihood that a loss will occur and minimizes the scale of the loss should it occur. Risk management includes both the prevention of potential problems and the early detection of actual problems when they occur.[1]

THE LESSER-KNOWN RISKS

Risk management systems and capacity building programs for microfinance institutions (MFIs) highlight mitigation of operational and financial risks... it is a business, after all. However, there are other risks that can result to serious damage if left unmitigated. Let's take a closer look at these "lesser-known" risks which warrant equal, if not more, attention:

(i) Reputation Risk
Bad publicity is certainly bad for business. In 2008, in India, a child was taken hostage by an MFI employee in exchange for loan. It was a short term solution which caused long term problems for the MFI: loss of clients, increased costs for damage control, difficulty attracting new clients (especially those with children), and lost income from a shrinking portfolio and additional PR expenses. A damaged reputation takes a long time and consumes a lot of resources before it could be repaired.

(ii) Mission Drift Risk
Deviation from the primary mission of helping people escape poverty says a lot about an MFI and could also have implications on reputation. One major cause of mission drift is when an MFI overlooks its social mission and focuses on growth and profitability to ensure company stability. It also occurs when services offered do not meet the needs of the target clients due to poor monitoring mechanisms.

(iii) Client Vulnerability Risk
If a client loses his source of income, gets sick, or is adversely affected by a natural disaster – he might not be able to pay outstanding loans. MFIs should be able to mitigate this risk through close study of a client's source of income and review of cash flows. Offering other financial products such as credit and insurance and having flexible loan repayment schemes could also help reduce client vulnerability.

It all comes down to one important thing: being customer focused. Knowing clients' needs, limitations, and having open channels for dialogue can help reduce the above risks. Specialized risk management systems in organizations usually focus on finance and accounting matters. Seldom attention is given on the social aspects of managing the organization and clients. This mindset should be disseminated in all levels of the organization. As the Social Performance Management (SPM) movement grows, more tools and best practices are developed and disseminated to enable MFIs to lend and to implement risk management practices with a social perspective.

To learn more about these risks and some ideas about mitigation, read the full guidance note[2] on "Risk management: Integrating SPM into Microfinance Capacity Building" by the Imp-Act Consortium available for download from: http://spmresourcecentre.net/

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[1] *http://edu.care.org/Documents/Risk%20Management%20Handbook.pdf*

[2] *This series of Guidance Notes emerges from a collaboration between the Imp-Act Consortium and key industry technical experts. Recognizing that the ongoing support to MFIs from funders and support organisations is critical to ensuring a balanced approach to performance management, this series aims to help them integrate the missing "social lens" into existing MFI training materials. The notes provide targeted guidance on critical issues, as well as details on further resources available.*

GOVERNANCE: BALANCING AN MFI'S MISSION INTO PRACTICE [3]

As MFIs struggle to maintain financial sustainability, meeting of social goals are put on hold. The traditional profit-oriented mindset prevails, where social performance management (SPM) is seen as extra "nice-to-have" rather than an essential requirement woven into the MFI's operational structure.

Effective governance plays a big role in sustaining an MFI's equal focus on social and financial goals. It is seen as the management process by which stakeholders guide the MFI to define and protect the social mission and protect the institution's assets. Below is a summary of best practices that could be adopted to further improve governance.

BALANCING SOCIAL AND FINANCIAL GOALS THROUGH THE MFI BOARD MEMBERS.

As the key decision makers of the institution, board members are expected to manage stakeholder relationships and drive the MFI towards success. To be able to improve social performance, boards should change paradigms and look at the double bottom line: both financial and social goals.

Therefore it is essential to clearly define the board's role in achieving social and financial goals and implement measures for accountability. Double bottom line focus could be emphasized during training to ensure that board members have a clear understanding of the importance of both aspects of the MFI's mission.

[3] *To learn more about governance, read the full guidance note on "Governance: Integrating SPM into microfinance capacity building" by the Imp-Act Consortium available for download from : http://spmresourcecentre.net/*

COMMUNICATING THE MISSION PROPERLY AND IMPLEMENTING A CODE OF CONDUCT

Perhaps it is the race towards accomplishing day to day tasks and having different interpretations of "success" which drives MFIs toward mission drift. Yes, mission and vision statements are plastered across physical structures, emphasized during special events, and published in MFI print materials – but are these being put into practice? The key is to be able to translate the mission into bite-size pieces that could be understood by all levels of the organization, making way for clearer objectives and action plans.

MONITORING SOCIAL PERFORMANCE PROGRESS THROUGH PROPER METRICS

Gone are the days when social progress can only be justified through success stories and narratives. To ensure that social goals are met, MFIs should be able to set clear targets and come up with relevant social performance indicators so that progress could be measured. Appropriate systems should be set up to ensure timely gathering and reporting of data.

A good source of these indicators is the Microfinance Information eXchange (MIX) portal , which lists social performance standards for reporting by MFIs

Some examples of indicators being measured by other MFIs are the following: outreach to target clients, client satisfaction with products and services, multiple borrowing by client households, reasons for exit, and improvement in the quality of life of clients and families.

EMBEDDING A SOCIAL PERFORMANCE COMMITTEE INTO MFI STRUCTURE

If MFIs are really serious about SPM integration, they should be ready to allot adequate resources. Implementing a social performance committee as part of the governance structure serves as a testament to the MFI's commitment. The creation of the committee also enables them to focus much needed attention to SPM.

The committee will be responsible for carrying out specific tasks that relate to: ensuring the credibility of social performance information, engaging staff at all levels, prioritizing social performance issues to be addressed, and bringing in relevant expertise for social performance research and analysis.

3RD SOCIAL PERFORMANCE REPORTING DATA COLLECTION

The Microfinance Information eXchange (MIX), along with the Consultative Group to Assist the Poor (CGAP), the Michael and Susan Dell Foundation, and the Ford Foundation are again recognizing MFIs and networks committed to transparent social performance monitoring and management.

On its 3rd year of SP data collection, MIX and the awards committee have decided to strengthen the award criteria, and have added a new level of award: Platinum.

The requirements to receive the various levels of the Social Performance Reporting Awards are as follows:

SILVER AWARD:

• Complete the social performance questionnaire found in the MIX Online Profile Editor
• Submit proper documentation to MIX proving the existence of reported social performance policies
• Report poverty measurement data to MIX

GOLD AWARD:

In addition to completing the requirements of the Silver Award, MFIs must:
• Have a social rating from 2008 or later
• Show social change related to their mission
• Show high levels of client retention based on their respective market

PLATINUM AWARD:

In addition to completing the requirements of the Silver and Gold Awards, MFIs must:
Fill out an additional survey assessing new indicators (MIX will send this survey to all MFIs in August)

To be eligible for the 2011 Social Performance Reporting Awards, MFIs must report social performance data to MIX by **September 30, 2011**. For more information about the Social Performance Reporting Awards, contact Ms. Micol Pistelli: mpistelli@themix.org

FININC ASIA AIMS TO ENHANCE FOOD SECURITY THROUGH CAPACITY-BUILDING FOR MFIS

The Microfinance Council of the Philippines (MCPI) partnered with PlaNet Finance for the local implementation of the "Improving Financial Inclusion and Social Impact toward Food Security in Southeast Asia" project, or FinInc Asia. The project aims to improve the food security of small farm households in rural Southeast Asia through the development of responsive financial products, capacity building on social performance management for MFIs, and financial literacy trainings for target clients.

This European Union-funded project was launched in the Philippines in July 2010 and will run until July 2013. Upon evaluation of SPM and AMF scores, only 8 out of 16 MFIs who applied were selected to participate in FinInc Asia namely Community Economic Ventures, Inc. (CEVI); GM Bank of Luzon, Inc.; Hagdan sa Pag-uswag Foundation, Inc. (HSPFI); Kabalikat sa Maunlad na Buhay, Inc. (KMBI); Lamac Multi-Purpose Cooperative (LMPC); Maranding Women's Investors Multi-Purpose Cooperative (MWIMPC); Paglaum Multi-Purpose Cooperative (PMPC); and People's Alternative Livelihood Foundation of Sorsogon, Inc. (PALFSI).

The program is being rolled out in stages, starting with the development of agriculture microfinance products and services that meet the needs of low income farmers. This will be followed by the institutionalization of social performance management (SPM) into the participating MFIs' strategies, enabling them to meet the needs of farmers and providing tools to track development impact. The third phase of the program is the conduct of several trainings on financial literacy, consumer protection and transparency programs for participating MFIs and their clients to ensure that the benefits of the products and services would be maximized. The final stage will involve network strengthening and knowledge sharing on lessons learned from the project.

Currently, demand and supply studies are being conducted together with the delivery of social performance assistance. Pilot testing for new agri-microfinance product and financial literacy trainings are expected to start within this year. Completion of FinInc Asia is seen to reduce the incidence of hunger, increase access to inclusive financial services among low income rural families, improve the social impact of microfinance programs and strengthen client protection mechanisms.

FinInc Asia project implementation in the Philippines is being managed by PlaNet Finance Technical Advisory Services, the technical assistance hub of PlaNet Finance in Asia which is based in Manila.

KEEPING TABS ON SOCIAL PERFORMANCE THROUGH INTERNAL CONTROLS AND AUDIT [4]

The financial statement is the main reference when gauging a company's success. These are presented to shareholders' meetings and published in annual reports. As primarily social institutions, MFIs should be able to also measure success through standard social performance indicators and look beyond income and profit. It is "business as usual" when companies verify the numbers for their income statement. For social success, however, measurement and verification of impact is still considered as extra work – which should not be the case.

If MFIs are serious about their mission, they should strive to integrate social performance management (SPM) into internal controls and audits. The Imp-Act Consortium gathered emerging control practices that promote this integration:

RAISING AWARENESS ABOUT THE IMPORTANCE OF MONITORING SOCIAL PERFORMANCE

Monitoring social performance is a good management practice and shows how serious an MFI is in achieving social goals. Internal auditors should be equipped with the right tools and skills to be able to measure indicators and should be trained to treat the task as important as the finance audits. It is also important to relay the business case of SPM to all levels of the organization: good social performance is not just the "nice thing to do", it also translates to better business.

KNOWING HOW TO MEASURE SOCIAL PROGRESS

Clear goals enable MFIs to set defined directions toward success. Setting up SMART (Specific, Measureable, Attainable, Realistic, and Time-bound) goals even for social performance will make measuring and gathering data easier. For example, if the goal of the MFI is to reduce poverty, a relevant indicator would be client income levels. There should be mechanisms in place to track income levels at certain periods. Systematic monitoring allows for more accurate data analysis and lets the MFI adjust procedures and products to help serve clients better.

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[4] *To learn more about governance, read the full guidance note on "Internal controls and audit: Integrating SPM into microfinance capacity building" by the Imp-Act Consortium available for download from : http://spmresourcecentre.net/*

PREVENTING CLIENT OVER INDEBTEDNESS

Limiting loan payments to a certain percentage of monthly income will help prevent over indebtedness. MFIs serving specific areas could also set up a system, such as credit bureaus, to know whether clients are borrowing too much or are already buried in debt from other MFIs and lending institutions.

MONITORING HOW CLIENTS USE LOANS

MFI loans are meant to be used to increase the quality of life. There must be a means to verify whether clients are using the loans for such purposes. Loan terms must be clearly explained to clients and periodic follow-up visits could be conducted to ensure proper loan utilization.

ENSURING COLLECTION PRACTICES FOLLOW CODE OF ETHICS

Establishing a code of ethics sets the ground rules for staff and somewhat serves as a guide for what one can or cannot do. This is important particularly on collection practices, when some MFI staff resort to drastic practices in collecting loans. These "unorthodox" collection strategies could lead to reputation risk and loss of clients (i.e. threatening clients with abusive language, or in a case previously discussed, holding a child hostage to get a client to pay). Management should be able to monitor staff behavior and their compliance to code of ethics. Likewise, clients should also have ready access to an effective feedback or complaints system.

MITIGATING CLIENT VULNERABILITIES AND ENSURING CLIENT PROTECTION

Borrowers are always vulnerable to shocks such as natural disasters, sickness and death of family members. Client vulnerability could be addressed through the creation of other financial products such as credit, insurance, and flexible loan repayment schemes. Internal auditors should make sure that loan restructuring processes are done fairly, and that there are systems distinguishing these from regular loans.

ENSURING QUALITY SERVICE AND TRANSPARENCY

Good customer service should be an inherent characteristic of MFIs. Management should strive to keep this at top priority through participatory and interactive staff trainings which promote respect towards clients no matter what the situation is. MFIs could carry out customer satisfaction surveys and exit interviews to measure whether staff are indeed giving good service. Information of customer satisfaction should also find its way to the audit reports as this is also an essential measure of social success.

CHECKING AVAILABILITY AND RELIABILITY OF SOCIAL DATA IN THE MIS

Social data must be measured so it can be managed. MFIs can better judge social success if these can be measured , and can make necessary changes to overall operations once results are read and analyzed. The internal audit process should oversee data collection, its accuracy, consistency, and the process used to collect it. Social indicators should be fully embedded in these processes.

PROTECTING STAFF AGAINST BIASES

Staff should be protected by clear HR policies which prevent biases in hiring, firing and promoting. There should be feedback channels where they can express grievances, other than their direct supervisors, and where they can expect to be treated objectively. Performance appraisals should be created in such a way that biases are avoided.

ENSURING QUALITY OF IMPLEMENTATION

Internal auditors can play an important role in ensuring that MFI staff (such as loan officers) are performing their roles well. Since tradition dictates that staff performance is measured through portfolio quality, there is a tendency for staff to overlook quality of service such as provision of training, advice or support and thorough assessment of a client's ability to pay to prevent over- indebtedness. To keep quality in check, regular client feedback collection could be done by internal auditors. Field staff should also be under constant supervision and be given enough support to maintain consistency and quality of service.

MCPI SPM ACTIVITIES UPDATE

SPM PEER LEARNING COMMUNITY

One of the major Peer Learning Community events in 2010 was the Level Up Workshop for member MFIs' top and middle management. The three-day course aimed to help MFIs operationalize their SPM strategies through integration in their financial system, field operations, human resource management, and management information system. One of the key lessons learned then was that SPM has to be woven into the MFIs' culture to make it work.

As a follow up to that workshop, a two-day leaders' retreat was held last February 24-26, together with the top and middle management of the Negros Women for Tomorrow Foundation, Inc. This activity was facilitated by Dr. Juan A. Kanapi, Jr.

The workshop aimed "to enhance the participants' ability to sense and bring into the present one's highest future potential, as an individual and as a group, and to collectively create the future that wants to emerge". The theme was inspired by a quotation from Otto Scharmer, a senior lecturer from the Massachusetts Institute of Technology, whose "presencing" – learning from the emerging future – technique was used in the workshop.

MCPI, Grameen Foundation and Oikocredit recognize the critical role of top management in building the SPM culture in MFIs. Integrating SPM not only shapes the future of individual MFIs but also benefits the entire microfinance sector.

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MCPI SPM ACTIVITIES UPDATE

PRICING TRANSPARENCY INITIATIVE LAUNCH

Last March, the MicroFinance Transparency launched the Transparent Pricing Initiative in the Philippines. MFTransparency partnered with the Microfinance Council of the Philippines (MCPI); Rural Bankers Association of the Philippines (RBAP); Mindanao Microfinance Council (MMC); and the Alliance of Philippine Partners in Enterprise Development (APPEND) to host a series of half-day workshops on transparent pricing in key cities nationwide—Davao (March 22), Manila (March 24) and Iloilo (March 28). The workshops were attended by more than 150 participants representing a range of microfinance service providers including NGOs, banks and cooperatives as well as microfinance networks and other industry stakeholders.

The Transparent Pricing Initiative encourages transparent communication between microfinance institutions and clients. MFTransparency collects pricing information from microfinance providers and presents it in a clear and consistent fashion, enabling comparison among prices and an understanding of the full costs paid by borrowers. MFTransparency supports this data publication with training, workshops and educational materials on interest rates and product pricing.

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