17th Microcredit Summit: Generation Next: Innovations in Microfinance

DAY 3 – September 5, 2014

The morning plenary was entitled **Making Markets Safe for the Vulnerable.** It turned out to be a heated discussion about interest rates and profits made by MFIs. A vigorous debate on the subject ensued between Chuck Waterfield, CEO of Microfinance Transparency and Jorge Kleinberg a representative from ProDesarrollo, a Mexican MFI network.

- Chuck Waterfield noted that he has been collecting date on pricing in 30 countries "with loans going to 50 million clients", and pointed out that Mexico's microfinance sector charges one of the highest interest rates in the world when compared with other countries. For example, average pricing in India is around 30%, Bolivia's is on average 20% [although a recent government decree calls for 11% interest rate cap], and Uganda can be between 50% and 100%. But, interest rates in Mexico can range from 95% to 154%! He cited Compartamos which charges some 108%. In 2013, according to Mr. Waterfield, Compartamos generated US$275 million in profits and distributed US$200 in dividends to its shareholders; ensuring a 50% ROE. Probing "how much is too much?", he implied that the microfinance industry's self- regulation is partly at fault. He noted that the industry's self- regulators -- such as the Smart Campaign-- certify MFIs that don't necessarily abide by their missions of serving the poor with defined responsible pricing. Of the 22 MFIs that were certified last year by the Smart Campaign, Compartamos was one of them. Turning to the audience, he asked "Are there ethical limits to profits?" and urged the microfinance industry to define responsible practices that include fair pricing. He did not dismiss the notion that 'reasonable profit' for a social business is acceptable; and queried what is 'reasonable'?

- Jorge Kleinberg explained the high cost of borrowing by microfinance clients in Mexico is due to geographic factors, noting that Mexico is a large country with low population densities in rural areas making it difficult and expensive to service them. Mexico, he noted, has the largest poor population in Latin America living marginally; and claimed that Mexico has the lowest profit margins in the region with 1/3 of MFIs operating at losses, 1/3 are struggling, and 1/3 are making profits. He noted that small loans are expensive to service resulting in high operating costs. It costs their institution $100 annually to serve each client. [Perhaps there is a problem in the product design, Mr. Waterfield noted. Instead of making multiple small loans which cost more to service and necessitate additional and more frequent borrowings, why not extend larger loans that will reduce the cost of borrowing?]

Highlights of **workshops** attended:

- **Successful Product Development and Delivery for the Next Generation** focused on financial services for youth, which the United Nations defines as those aged 15-24. Making Cents emphasized that in developing products, it is important to: understand who constitutes youth; and they target population has to participate at all stages of the product development. (e.g. girls like pink credit cards). Youth variations depend on: age, life cycle, gender, education, vulnerability and location. Young people need to feel safe and secure. Financial life skills presentations can be included in weekly savings groups to ensure a holistic approach – financial services and non-financial services. This is a difficult segment to reach so it should be viewed from a purely social responsibility perspective. Fonkoze adopted a youth program but encountered obstacles. An identify card is needed to open a savings account but in Haiti youth under 18 are not eligible for such cards, so they have to obtain a co-signor. In Mali and Ecuador, Freedom from Hunger, youth receive a higher rate for savings than other savers [to encourage savings]. Financial education in Ecuador is facilitated in schools.

- **How Social Performance Impacts Financial Resilience and Default Probabilities** delved into loan pricing, investor returns and risk assessments. Michael Krell of the MIX presented highlights from their recent study on the value of social performance management (SPM) and its interaction with financial performance. It measured governance, poverty outreach, products and transparency as reported by MFIs. The study found a positive correlation between social performance and financial results if the institution has an established social performance committee; and poverty targeting by MFIs is associated with lower efficiency and return on assets. A survey on social performance collected from 292 MFIs by Moody's indicated that portfolio at risk is a good predictor of default. They looked at correlations between financial and social risk and examined if social factors (e.g. governance, management) contributed to financial returns. Jody Rasch noted that studying correlation between financial and social risk doesn't matter because it doesn't change behavior. He noted that a social investor will look at social factors even though there is no correlation and a financial investor will only look at financial factors even if there is correlation. The research showed that portfolio at is not a good predictor of default while debt collection practices (socially positive ones) are better predictors.

The **closing plenary** ended with both cautionary and optimistic summations on the future of microfinance in light of overindebtedness issues, technological innovation, consumer protection, emphasis on social business and building appropriate infrastructures to support poverty alleviation goals.