

## Responsible pricing: field evidence

*Guidance remarks for responsible inclusive financial service providers and stakeholders.*

### Rationale

[MicroFinanza Rating](#) would like to share its experience in assessing responsible pricing and to provide some operational guidance to financial service providers (FSPs) to promote best practices. The recommendations presented here largely draw upon the research and guidance provided by responsible inclusive industry stakeholders, namely [MFTransparency](#), [Smart Campaign](#), and the [Social Performance Task Force](#).

### Expertise

MicroFinanza Rating has conducted over 1,670 assessments, including more than 70 Smart client protection certifications and surveillance audits, in 103 countries. The assessments incorporated the evaluation of FSPs' pricing policies, procedures and practices against their social missions that often seek to serve vulnerable population groups with appropriate products and services. Specifically, they focused on the degree to which FSPs are transparent and responsible in pricing their services and, ultimately, balancing institutional sustainability with affordability from the consumer perspective.



### Background

Responsible pricing remains a challenging issue with no clear-cut answers. However, key guidelines and tools have been developed to guide FSPs in strategic decision making. Notably, they include MFTransparency's proposed approach to defining balanced pricing<sup>1</sup> and the Smart Campaign's new framework grounded in "assessments by induction"<sup>2</sup> that replaced the market-based comparative approach to assessing fair pricing in client protection certifications. At the core of these frameworks is the understanding that the main variables influencing pricing are profit and operating efficiency, over which FSPs have reasonable control.

<sup>1</sup> Waterfield, Chuck, July 2015. "Balanced Pricing Microfinance: Setting Prices to Balance the Needs of the Institution and the Clients?"

<sup>2</sup> Rozas, Daniel, January 2016. "Assessing Price Fairness in Microfinance."

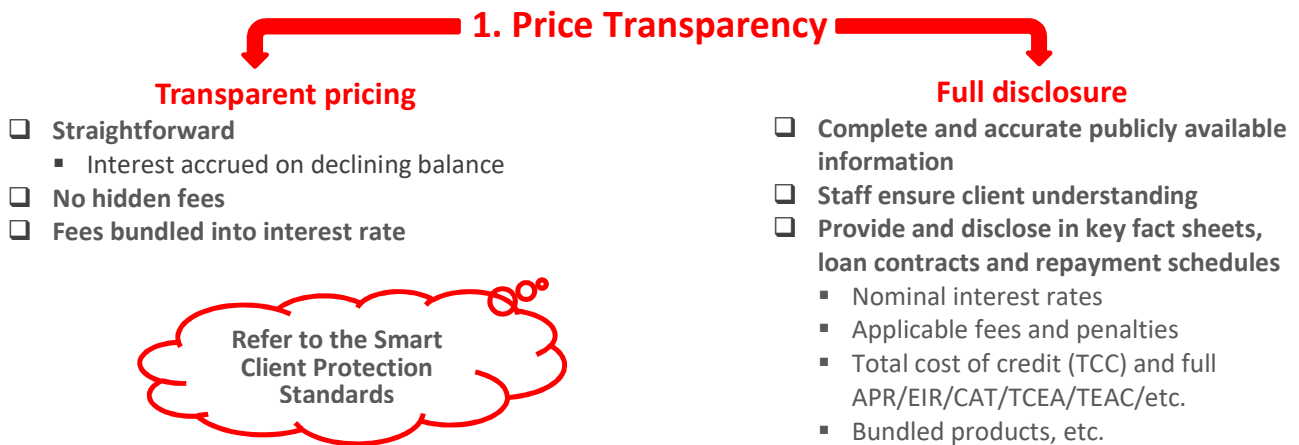
### What we see in practice

The assessment of responsible pricing is twofold: how transparent the pricing is from the client perspective and how fair it is overall, accounting for institutional sustainability, profitability and price affordability for the client. Below are some of the salient observations we have made over the years. By and large, they reflect the policies defined by FSPs.

- ❑ **Pricing and cost structures vary by country, loan size and loan term**
- ❑ **Pricing policy lacks documentation**
- ❑ **Complex loan pricing from the client perspective (no disclosure of APR/EIR/CAT/TCEA/TEAC/etc.):**
  - Flat rates
  - Upfront and ongoing fees
  - Compulsory savings impacting client cash flows
  - Penalties and prepayment fees.
- ❑ **Related service fees:**
  - Transaction fees
  - Additional services (e.g. insurance, SMS notifications, etc.)
- Collateral fees
- Taxes
- Third-party fees (e.g. payment terminals, mobile payment services, post offices, agent networks, etc.).
- ❑ **Incomplete disclosure of loan cost in public domain and contracts**
- ❑ **Staff training and competency to ensure client understanding**
- ❑ **Lack of systematic internal control over pricing transparency and policy implementation**
- ❑ **Countries with interest rate caps on loans that are indiscriminate of small loan providers.**

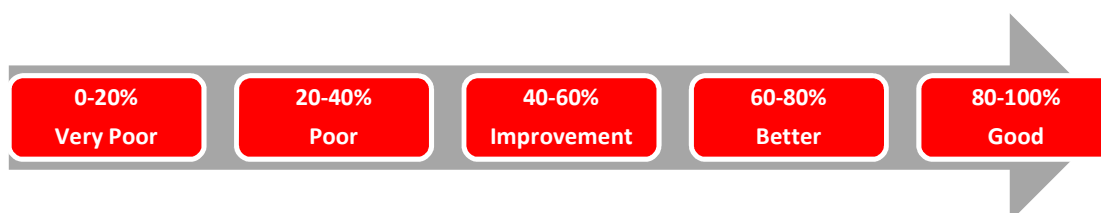
### Responsible practices

The following guidance remarks draw upon the standards set forth within the Smart Client Protection Principles. They are meant to inform governance-level discussions and decision-making within FSPs.



**Tool:** The degree of price transparency can be measured using the MFT [Pricing Transparency Index](#). FSPs are advised to build all relevant loan costs for the client into the interest rate to achieve a high index.

$$\text{Pricing Transparency Index (\%)} = \frac{\text{Quoted annual nominal interest rate}}{\text{Full APR (interest + fees + insurance + tax + deposit)}} \times 100$$



## 2. Pricing Policy

### ❑ Define and document policy and procedures

- State how you will balance institutional sustainability with client interests (e.g. capacity to pay, lower interest rates, value-added services, etc.);
- Define (un)acceptable profit levels and a pricing calculation method (formula) capturing OpEx, FinEx, LLEx and acceptable profit levels;
- Define procedures, responsible staff and functions (e.g. ALCO, interdepartmental committee), monitoring processes, and frequency of policy revision;
- Institutionalize non-discriminatory pricing against Protected Categories;
- Document mechanisms for internal control over uniform policy implementation;
- Report regularly to the management and the Board of Directors your performance against policy to discuss challenges and opportunities of balanced pricing.

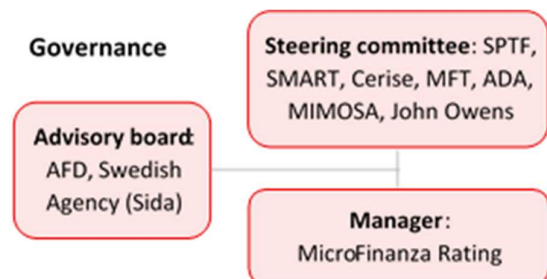
### ❑ Monitor and manage policy implementation

- Assess product pricing transparency, using the Transparency Index;
- Collect competitor price information (e.g. mystery shopping) to compare prices (APR/EIR/CAT/TCEA/TEAC/etc. relative to average loan size) of similar products and address gaps;
- Assess against the accepted ranges for ROA (1-3%), OER (expected range), and LLER (<5%);
- Disclose full pricing information (including APR/EIR/CAT/TCEA/TEAC/etc.) in offices, marketing materials, contracts (incl. Key Fact Sheets) and monitor compliance;
- Train staff systematically to disclose and explain pricing to all clients;
- Manage efficiency (e.g. productivity, operating expenses), portfolio quality and profitability to avoid passing on the cost of controllable institutional inefficiencies to clients.

### MicroFinanza Rating services

MicroFinanza Rating offers training services to FSPs seeking to align their pricing policies and practices with international best practices. Stakeholders (e.g. investors, donors, board directors, etc.) can benefit from the trainings by building the assessment into their due diligence requirements to verify and ensure their investees and beneficiaries uphold these best practices in their activities.

Industry stakeholders are also invited to support a global effort—overseen by the Smart Campaign, the Social Performance Task Force, and MFTransparency—to establish an online [Data Platform](#) for centralizing and benchmarking FSPs’ social and financial metrics including validated annual percentage rates, pricing transparency indices, and client protection practices. Managed by MicroFinanza Rating, the platform will draw data from over 600 FSPs across more than 70 countries. The APRs are calculated by independent parties (e.g. rating agencies, investors, etc.) or FSPs themselves, using a consistent, internationally recognized methodology.



### References

- ❑ MFTransparency. Waterfield, Chuck, July 2015. “Balanced Pricing Microfinance: Setting Prices to Balance the Needs of the Institution and the Clients?”
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- ❑ Smart Campaign. Responsible Treatment of Clients: Practicing Non-Discrimination.