

## Cost and Pricing of microfinance

There is a widely spread and important misgiving about the pricing of microcredit in the EU, which often leads to inappropriate references to usury interest rates.

The fact of the matter is that the all-in cost of microcredit (APR) is difficult to calculate on a comparable basis but is relatively high (it can go above 20%) and it varies according to the specific environment in each Member State. The interest rate itself is an easier comparison point. It varies quite substantially across Member States and has been calculated at the average level of 10.7%<sup>1</sup> for business microloans in 2015. In the current period of quasi zero base rate – these figures may seem too high.

**The first point** to make is related to the objective of social and financial inclusion of microfinance in the EU, which implies a target population of poor and disadvantaged clients who cannot access the normal banking world, notably for lack of credit history and collateral. This means that only face-to-face repeated contacts can allow the development of a relationship, an assessment, and training and coaching services, leading possibly to a microcredit operation. Such an approach is obviously costly, particularly when comparing to automated algorithms used for other segment of the credit markets. It is even more costly in relative terms since the average size of a microcredit in the EU turns around € 8,000 and its average term is 41 months<sup>2</sup>. This unfavorable relation between operational costs and limited returns per operation due to very small loan volumes explains why commercial banks are not interested to serve MFIs clients and justifies the relatively high percentage pricing. At the same time, it can be observed that microfinance clients are concerned about access to finance, not about price. Indeed, from the client's perspective, the amounts to be paid remain very small and affordable in absolute terms, which is one aspect that is carefully checked during appraisal in order to avoid pushing clients into further fragilities and/or over-indebtedness.

**The second counter-intuitive point** to make is that this relatively high level of pricing is not due to particularly high provisioning and loss rates. Indeed, the average level of losses incurred by microfinance institutions (MFIs) in the EU is generally comparable to the average level of mainstream bank credit and often even inferior. Again, comparisons are delicate on this and reported figures for banks and MFIs generally represent losses after calling guarantees and collaterals. More detailed data on this issue are reported in the EMN-MFC survey<sup>3</sup>

**The third point** worth mentioning is the cost of funding for MFIs, which can be high because of the perceived high risk of such institutions. Even when supported by the public sector, MFIs often have funding and funding cost issues.

**[The fourth point** concerns an aspect that is constitutive of microfinance i.e. the necessary accompanying measures or non-financial services (or business development services) that are essential to allow the potential beneficiary of a microcredit to be trained and coached on the fundamentals of e.g. finance, accounting, taxes and management. Several models exist across the EU for the organisation of such services, which is normally done on the basis of voluntary workers or public subsidies or a separate entity and thus involves no direct cost for the MFI. Nevertheless, this intrinsic component of microfinance may involve an element of additional indirect cost for MFIs.]

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<sup>1</sup> Joint EMN-MFC survey of microfinance in Europe in 2014-2015

<sup>2</sup> idem

<sup>3</sup> idem

**Last but not least**, the objective of microfinance in the EU being social inclusion rather than profit, most MFIs reinvest their returns into their business to serve more excluded clients, which makes it unlikely that they set interest rates for usury (unethical levels designed to enrich the lender). It is also easy to observe that most MFIs are not financially sustainable without a degree of public support which is another evidence that their pricing level is not exaggerated compared to their costs. In fact, depending on their specific environment, MFIs generally organise their cost coverage by a combination of pricing (limited by the clients' repayment capacity and sometimes by interest rate regulatory caps), public or private subsidies and a good system of public guarantees. The public support having to be assessed in relation to the social impact.

**As final comment**, it must be stressed that the all-in price or annual percentage rate (APR) is normally not published by providers of business credits, be them small or large, but is generally required for consumer or mortgage credit. Microcredits being "business credits", it remains difficult to establish transparent comparison points with alternative sources of business finance.

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