Mexico's Prospects for Full Financial Inclusion

A White Paper from the Financial Inclusion 2020 Project

Draft for Discussion

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CENTER FOR FINANCIAL INCLUSION AT ACCION INTERNATIONAL

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Foreword

Providing quality financial services to all citizens who can use them is an important national goal that can benefit millions of citizens. With exciting potential actions by service providers, facilitated by enabling government policies, we believe Mexico can achieve full financial inclusion by the year 2020. The purpose of this paper is to provide information and analysis on the prospects for reaching this goal, information that supports leading businesses, government agencies and non-profit organizations to take steps that will substantially advance financial inclusion. We offer the paper as a focal point for dialogue among analysts and decision makers, in the hopes that it will contribute to building the national agenda.

This paper is the first product of the Financial Inclusion 2020 project, an ambitious initiative by the Center for Financial Inclusion to accelerate progress towards full inclusion around the world by 2020. The project will do this by providing information and analysis relevant for decision making and by creating opportunities for dialogue among decision makers. It is designed to address the multiple leverage points for bringing nearly three billion currently excluded people into the formal financial system. In 2009, the Financial Inclusion 2020 team began an in-depth look at Mexico, a country with both great need and great potential. The Mexico work will in turn provide the analytic framework that will be drawn upon to bring Financial Inclusion 2020 to additional countries in 2010.

The Center for Financial Inclusion at ACCION International is an action, research center that works on behalf of the microfinance industry as a whole, serving as a bridge to leverage private-sector interest in microfinance. In collaboration with nonprofits, commercial banks, technology firms, regulators, universities, and many others, the Center works to bring the best minds and expertise to bear on challenges facing the industry. The Center is dedicated to the proposition that low-income people deserve high-quality, regulated financial services, and that those services are best provided through sustainable, commercial programs that incorporate social purpose.

The Center would like to acknowledge the many people who have helped in the production of this paper. We have been privileged to work with a team of excellent technical partners who have made significant substantive contributions. Thank you to Jorge Highland and Jeff Toohig of the Grameen Foundation, Kate McKee, Xavier Faz, Mark Pickens, and Alejandro Ponce Rodriguez of CGAP, and Beth Houle of Opportunity International for guiding us regarding content, strategy, and specifics. We thank a group of Dartmouth College students associated with Tuck Business School, the Paganucci Fellows, who also provided analytic input. Finally, thank you to Monica Brand, Michael Murai, Amitabh Saxena, Maria Jaramillo, Cara Forster and Nicholas Wolf, from ACCION International for their insightful comments and expertise. We are also very thankful to Brian Clancy, Chair of the Center's Advisory Council for his support and advice.

In addition, we are especially grateful to McKinsey and Company, a global management consulting firm with deep expertise in financial inclusion and a strong commitment to the social sector. We are thankful for their guidance, insights and on-the-ground analytical support in Mexico, all of which helped to shape the Center's thinking on this topic.

The Center for Financial Inclusion team members who contributed to this project include Anita Gardeva, Joshua Goldstein, David Levai, Kelley Mesa, and Elisabeth Rhyne.

The Center for Financial Inclusion team takes full responsibility for the findings, recommendations, and opinions expressed within this paper. All errors and omissions are ours.

Part I. A Vision for Full Financial Inclusion

Financial inclusion creates better and more equal opportunities for people to improve their lives. It fosters economic justice and allows all citizens to contribute to a productive economy and society. Mexico has both the need and the potential for full inclusion. Our Financial Inclusion Scorecard calculates that 45 percent of all households do not use any financial services, a number that reflects both important recent strides and a major future challenge. Many more households are only partially included—using only one or two services and doing so sparingly and at low quality.

Yet Mexico's open-market economy and thriving financial sector hold promising potential. This white paper contends that full financial inclusion in Mexico by 2020 is both achievable and a worthy national goal.

The purpose of this paper is to provide current market information and analysis to support the ongoing dialogues among policy makers and providers about the goal of full financial inclusion and how to achieve it. It seeks to contribute in several distinctive ways. The paper:

- **Defines financial inclusion to include a full suite of products offered at a high quality**, and argues that this comprehensive definition should be considered in setting goals.
- **Introduces the Financial Inclusion Scorecard** as a basis for measuring Mexico's current status and future progress.
- **Projects trends forward to 2020** to identify areas where gaps would be most persistent if nothing new were done.
- **Identifies who is excluded**, especially low-income, rural, and informal segments of the population.
- **Considers a wide range of potential providers**, including financial and non-financial businesses, with special attention to the growing importance of the microfinance sector in reaching the poor and excluded.
- **Identifies some of the top opportunities** for closing inclusion gaps. The exploration of opportunities in this paper is preliminary. The objective of this paper is to open the door to further dialogue to develop the best ideas more thoroughly.

The audience for this paper includes decision makers in government, the private sector and the social sector who are involved in some aspect of inclusive finance. We are mindful of the lively context in Mexico, with strong government commitment and many active providers. We expect that this audience would use this broad and fact-based look at financial inclusion as input into their choices of practical next steps. In addition, non-providers can support the process through steps such as the following:

- Dialogue to enhance consensus about strategy
- Research to inform specific actions
- Pilots to test innovations

By revealing new possibilities, such actions can clear the way for providers to expand services to new markets.

Table 1. Full Range of Financial Services Relevant for Low-Income Households and their Enterprises

(Italicized services are the basis for the Financial Inclusion Scorecard)

CREDIT	SAVINGS	INSURANCE	PAYMENTS
Personal	***Savings account***	***Life***	***Money transfers***
Consumer	***Checking/current account***	Health	***International transfers***
Credit card	Certificate of deposit	Property	Bill payment
Education	Pension	Disability	Government transfers and benefits
Mortgage	Youth savings	Agriculture/crop	ATM/debit cards
Home improvement	Program savings	Credit life	e-Payments
Microenterprise			
Business fixed asset			
Leasing			

Defining Full Financial Inclusion

Full financial inclusion is a state in which all people of working age have access to a full suite of quality financial services that includes payment services, savings, credit, and insurance. These services are provided at affordable prices, in a convenient manner, and with dignity for the clients. The comprehensive nature of this definition anchors our vision to the end goal of full financial inclusion—unlocking the social and economic potential of all who are currently excluded from the financial system.

The Financial Inclusion 2020 project promotes this comprehensive definition of full financial inclusion in preference to narrower definitions commonly used.[1] The definition proposed here includes both product range and service quality.

Range: a basic suite of four services. The financially excluded have much the same range of financial needs as better off and already included people. If we consider low-income families, especially those operating in the informal sector, running family farms or microenterprises, or whose relatives have moved to other countries seeking employment, we could envision a complete range of products that might be relevant (see Table 1). While such a wide product range is foreseeable, we acknowledge that this is a long-term effort, and focus here on a more attainable goal—a suite of basic services (the highlighted services in Table 1).

We define full inclusion to include basic services in four categories--savings, credit, insurance and payments—and use them to construct our Financial Inclusion Scorecard. The four core services address common financial needs experienced by households of all income levels and by small and microenterprises. Access to a full suite allows these households and businesses to make the best use of their resources. We concentrate on the basic core products in each category, a necessary first step toward developing a wider range. These products are already available on the market in a form suitable for lower-income people.

Quality: affordability, appropriateness, convenience, and dignity. Any goal setting around full inclusion must take quality into account. Quality cannot be an afterthought because of the wide difference in the value to clients of services provided with and without the dimensions of quality we consider. In order for services to be both accessible and beneficial, they need to be provided with quality. Unaffordable and inconvenient services reduce access, and products that do not fit the needs of the clients and are not provided in a transparent manner can even harm clients. Too often, analysts of financial policy have been content to consider only the dimension of access, counting people as included even if the services they receive are of a poor standard.

We use these dimensions of range and quality to construct the Financial Inclusion Scorecard presented below, where it becomes apparent that much

[1] In particular, the terms “banked” and “unbanked” generally refer to the use of a single service, such as a basic savings account.

more data is available to track access, while assessing quality is still at an early stage.

Why does Financial Inclusion Matter?

Financial inclusion is an important national goal for a multitude of reasons. It has the potential to make an important contribution to the Mexican economy while at the same time reducing social inequality. Most fundamentally, financial services enhance the quality of life and economic productivity of the low income households and small/microenterprises that gain access to them. These households and enterprises benefit in seven distinct (although related) ways.

1. **Facilitate economic transactions.** In the absence of payment services, business owners and individuals travel long distances and wait in lines to make payment transactions. This can be time-consuming and risky. For many transactions, costs become prohibitive. In Mexico, between 35 to 40 percent of households live in towns without a financial service outlet.[2] Mobile payments, which in some countries cost as little as US $0.05 per transaction could potentially bring these households significant benefits.[3]
2. **Manage day-to-day resources.** Low-income families have small and unpredictable incomes, often seasonal. They can use credit and savings to tap into past or future income, helping them to take advantage of immediate opportunities or smooth their consumption.[4] The availability of savings and credit also prevents consumption needs from crowding out investments. Similarly, microenterprises need working capital to operate smoothly.
3. **Improve quality of life.** Families use financial services to gain access to education, health care, and other necessities that improve their quality of life. Home improvement loans, school fee loans, and health insurance can help make major differences in daily well-being.
4. **Protect against vulnerability.** Low-income people face many vulnerabilities, from illness, to theft, to unemployment. Savings, credit, insurance, and even remittances provide sustainable and low-cost coping strategies. If a household loses a source of income, it might not have to withdraw a daughter from school, sell a valuable asset, or fall deeper into poverty. If recent trends were to continue, then in 2020 there would be an estimated 6.8 million moderately poor Mexican households who could fall into extreme poverty if faced with a health or business emergency.[5]
5. **Make productivity-enhancing investments.** In a household survey in Mexico, about one-third of respondents reported that they are self-employed or entrepreneurs.[6] These enterprises may use credit or savings to make investments in assets like a sewing machine, refrigerators, or farm implements.
6. **Leveraging assets.** The poor own assets, both social and physical. As Hernando de Soto has argued, without recognition by the formal sector, they cannot leverage these assets to build for the future.[7] Borrowing against assets can help households capture the financial value of their assets at once, facilitating long-term investments.
7. **Build economic citizenship.** Financial services foster independence, giving people greater ability to manage their resources. For example, microfinance impact studies from Bolivia reported that microfinance clients were more self-confident, more actively involved in local governments, and more respected within their communities.[8]

Achievement of full financial inclusion would give millions of Mexicans the financial tools to better manage their lives and economic activities. It is also possible that full inclusion could help reduce government welfare expenditures.

[2] See Figure 11.

[3] Jim Rosenberg, "How do you Price a Mobile Banking Service?," CGAP, August 25, 2008.

[4] For an excellent discussion on the day-to-day money management of poor households, see Daryl Collins, Jonathan Morduch, Stuart Rutherford, and Orlanda Ruthven, *Portfolios of the Poor: How the World's Poor Live on $2 a Day* (Princeton: Princeton University Press, 2009).

[5] See Figure 4.

[6] ENIGH, 2006.

[7] Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000).

[8] Nathanael Goldberg, "Measuring the Impact of Microfinance: Taking Stock of What we Know," Grameen Foundation, December, 2005.

At the macroeconomic level, it is well understood that financial deepening, the process of building the infrastructure of financial systems, can benefit a country, increasing GDP growth by increasing the efficiency with which productive activities receive the financing they need. Financial deepening can be directed at the economic activities of the rich, without full financial inclusion, but it will be better for Mexico if financial deepening and financial inclusion go hand in hand so that all economically active people contribute to the country's economic growth. This will help to transform Mexico from a country known for substantial economic inequality to a more fair and just one that comes closer to providing equal opportunities to all its citizens.

Where does Mexico Stand Today? The Financial Inclusion Scorecard

In order to design effective strategies for financial inclusion, decision makers including governments, multilateral agencies, NGOs, and of course the private sector, need accurate data, which can be tracked, specifically focused on financial inclusion. For the Financial Inclusion 2020 project we developed a national Financial Inclusion Scorecard to track progress toward full financial inclusion. The Scorecard is constructed around a comprehensive definition of inclusion, addressing the dimensions of access described above. It is intended to be used both to measure progress across time and to compare one country to another.

The Scorecard was developed using existing data sources; no new client surveys were conducted, but information from providers was combined in new ways. In the process, we discovered that data on financial inclusion needs to be greatly strengthened, and in this respect Mexico is no different from most other countries. Two particular issues stand out:

- **Household versus provider data.** Providers have very complete data on numbers and amounts of accounts, their information does not reveal who does and does not have access. For that we must turn to household data, and specifically the ENIGH surveys.[9] While these surveys are wonderfully comprehensive, they are not entirely satisfactory for measuring use of financial services, which is only one of their myriad purposes. In using such survey data, we focus on households rather than individuals or businesses, making it hard to reconcile provider information which is account-based. At the household level, usage of a product by a relative suggests that the rest of the household has access and benefits from the service. The average Mexican household has about 4 members and this is the basis for our calculations throughout the paper.[10]
- **Few sources on quality.** The concept of quality has not generally been integrated into financial inclusion measurement (with the partial exception of affordability), and thus we were faced with the need to construct indicators and search for sources. As a result, the indicators of quality shown here are highly preliminary. The attempt to measure quality calls attention to the need for dedicated research on this topic.

The first step in constructing the Scorecard is to quantify how many people use the four core products: credit, savings, life insurance, and payments (Table 2). In theory, access implies the ability to use a service, even if this ability is not exercised. However in practice, it is usage, rather than access, that is actually measured. We analyzed responses to the 2006 ENIGH surveys. These analyses allowed the following definitions of core services:

1. **Credit** refers to all sorts of loans (consumer, credit card-based, working capital, and mortgage) offered by a regulated institution, from the commercial and popular sectors. The measurement counts all respondents who state that they have a mortgage, make home repayments, or purchased goods using some form of credit (loan, bank, card or retail store card). We have excluded questions to which the answers may have indicated use of informal credit schemes.
2. **Savings** refer to any type of savings outside of the house. Therefore the number in our Scorecard could include some informal savings schemes,

[9] The Encuesta Nacional de Ingreso y Gasto de los Hogares (ENIGH) is done by the Instituto Nacional de Estadística y Geografía every two years. The survey is representative of Mexican Households in the national level and per town size. Data from ENIGH 2008 is still being analyzed by researchers and thus was not included in this paper.

[10] CONAPO, 2006.

Table 2. Financial Inclusion Scorecard: Mexico (based on data from 2006–2009)

DIMENSION OF INCLUSION	CREDIT	SAVINGS ACCOUNT	LIFE INSURANCE	PAYMENTS
Penetration				
Percent of all households that use service	26	37	18	
Percent of households living in towns with no banking outlets				35 to 40
Affordability				
Costs to use service	53% to 75% total annual cost (CAT)*	-3.5% to -2.8% real annual net return		
Minimum requirements		$12 to $45 opening amount	$6,250 to $16,281 insured amount for "accessible" policies	
Fees associated with service		$4 to $5.78	$15 annual premium for "accessible" policies	$0.40 (ATM) 5.6% of $200 (remittances)
Convenience				
Days to complete transaction	14.8	0	23.3	
Documents required (average)	4.4	2.6	2	
Phyisical proximity				See penetration of payments (above)

* CAT stands for *costo anual total* or the total annual cost of borrowing. It includes fees and commissions in addition to the interest rate.

Sources: Financial Inclusion 2020 team calculations based on provider data and the following sources: ENIGH, 2006; Global Insight; Banxico; AMFE; MIX; Condusef; CNSF; Actualidad Seguros y Fianzas; World Bank *Finance for All*.

as illustrated by the ENIGH question, "During the past year, did you make any deposit outside of the house: in a savings account, in a rotating credit association, in a credit union, etc.?"

3. **Life insurance** was measured in the ENIGH survey by counting households that listed life insurance premiums as an expenditure as well as those who receive it as an employment benefit.[11]
4. **Payment services** access could not be determined from ENIGH surveys. We therefore used an analysis of the number of households who live in the same town as a formal financial services outlet (i.e., branches but not ATMs) as a proxy for access to payments. We focused on outlets, rather than ATMs, because many payments (e.g., remittances, bill payments) require in-person interaction. This analysis is tentative. There is a lack of standardized data to measure products' affordability and convenience.[12] The affordability and convenience figures are the result of inquiries at a mix of commercial and popular sector institutions for price information on a basket of products most likely to be used by lower-income clients. For each analysis, three to five popular and commercial institutions were contacted, except for insurance, where only traditional insurers were examined.

Measurements on the suitability of products and treatment of the clients are more qualitative in nature and difficult to reflect in numeric form, but their lack of presence in the Scorecard is not indicative of secondary importance. The measures we track, such as the number of documents needed or the time to complete a transaction, are imperfect measures of these dimensions, but they give a rough view of some important aspects of convenience.

[11] The vast majority of life insurance is group insurance not individual, making it hardly accessible for those working in the informal sector.

[12] The World Bank's *Finance for All* does have some very strong cross-country data on the convenience of account opening at banks, though this analysis also includes non-bank lenders and the popular sector *(i.e., cajas de ahorro y credito popular)* for both credit and savings.

Table 3. Penetration of Financial Services and Access Points Across Selected Countries

	MEXICO	SPAIN	COLOMBIA	PERU
Savings (% of HH)	37	92	53	25
Credit (% of HH)	26	77*	23	15
Life insurance (% of HH)	18	N.A.	11	N.A.
Branches per 100,000 people	7.6	95.9	8.7	4.2
Branches per 1,000 km sq.	4.1	78.9	3.7	0.9

* Refers only to credit cards.

Sources: The Spanish Survey of Household Finances, 2005; Anuario Estadistico Asociacion Espanola de Banca, 2007; World Bank *Finance for All*; ENIGH, 2006; "Reporte de Bancariacion Septiembre de 2008," ASOBANCARIA; "Información Estadística y Financiera por Ramos de Suguro," Superfinanciera, December 2008; "Promoting Access to Financial Services: What does Data about Bancarization in Latin America Tell Us?," FELABAN.

Dimensions of Access

The Basic Product Suite. On dimensions of penetration, full inclusion involves access to a range of four basic formal financial services—credit, savings, life insurance, and payment services. Using ENIGH data, we estimate that 45 percent of Mexican households are completely excluded; they are not using any single formal financial service.[13] Another 50 percent of households are included in a limited manner (with access to only one or two services).[14] Last, there are 5 percent of Mexican households who report using savings, credit, and insurance and who represent the fully included portion of Mexico's population.[15] In Mexico, of these core financial services, savings are used the most by 37 percent of households. Life insurance is used by 18 percent of Mexican households. Credit is slightly more prevalent with 26 percent of households stating that they use it.

Comparing the penetration rates of financial services in Mexico and Spain—generally considered one of the most financially inclusive countries—allows us to put the penetration gaps in Mexico in perspective (Table 3). Mexico is far behind Spain in terms of actual usage of most core financial services, as well as the physical availability of service outlets.

Reaching All People. In examining penetration of financial services it is most important to look at who receives services and to understand whether services are reaching the lower income and disadvantaged groups of the population. The Scorecard in summary form does not show this, but we explore this question in much more detail in a later section.

Dimensions of Quality

Affordability. In Mexico, credit and savings need to become more affordable to offer greater value to users. The analysis here represents the total annual cost of credit (or CAT) which includes the interest, fees, and commissions associated with borrowing. The Scorecard shows that the total costs of borrowing bring the annual interest rate up to 53 percent for a commercial loan and 75 percent for a popular sector loan; borrowing in both the commercial and popular sector in Mexico is expensive. In order for credit to be more accessible and bring more value to clients, it will have to become affordable.

Savings accounts in Mexico also exhibit a gap in value for the client. At the least, it is desirable for a savings account to retain the real value of the client's savings. Protection of the value of savings is a minimum standard that is, nevertheless, often not available to low-income people around the world. In Mexico the average real rate of return on commercial savings accounts and popular sector savings accounts that we examined was

[13] We are counting inclusion in this instance by use of savings, credit and insurance, because our numbers are based on the 2006 ENIGH Household Survey, which does not contain detailed information on payments.

[14] A more conservative estimate by the World Bank's recent *Finance for All* finds only 25 percent of Mexican adults have a bank or credit account with a formal financial institution.

[15] As noted above, usage data tends to underestimate access because some (an unknown amount) people have access but do not use services.

-2.8 percent and -3.5 percent, respectively. A negative real rate of return on savings accounts is a disincentive to save in financial form that could cause savers to seek non-financial or informal savings mechanisms, which are often less secure.

As recipients of remittance payments from abroad, Mexicans can benefit from a reduction in the average cost to transfer money internationally, as 7 percent of households report receiving income from abroad. Transferring money from the US to Mexico (one of the largest remittance corridors in the world) cost an average of 5.6 percent of a US $200 transfer in 2008.[16] In comparison to El Salvador and Honduras, two neighboring destinations of remittances from the US, it is more expensive to remit to Mexico (in El Salvador it cost 4.6 percent of US $200 in 2008, and in Honduras, 4.7 percent).[17]

Convenience. For low-income people, convenience is especially important. The bureaucratic requirements of acquiring a financial service, opening hours of a branch, or the distance to and from a bank can discourage or even prohibit the use of financial services. In sparsely covered areas, costs of traveling to the nearest branch can add up to significant amounts of money and time, and there are increased risks of theft or loss of cash. In Mexico it is estimated that close to 10 million households live in towns without a formal financial-services outlet. Electronic and mobile payment services are convenient ways to reduce these costs; however, few transactions in Mexico for people at the base of the pyramid are electronic.

In Mexico, issuing a life insurance policy and being approved for a loan takes time, around 23 days and 15 days, respectively among the institutions we studied. Furthermore the requirement of 4.4 documents on average for a loan approval presents barriers for those who lack the necessary documentation. Such barriers discourage the use of formal services and informal financial services are often faster and easier to access. Finding ways to bring down the number of days and documents required to use formal services will help to make them more attractive and accessible.

Product Fit. The idea that a product should be designed to fit the needs of different clients is as important for financial inclusion as affordability or convenience. Microenterprise loans, for example, emerged to fill the need of self-employed people for small amounts of working capital. On the other hand, credit-life insurance, a product that pays to cover outstanding debt in the event of death and one of the most common forms of insurance at the base of the pyramid, is of relatively little value to the family of the client. In addition to the need for developing new, more appropriate products, providers can also incorporate product features that address the nature of the poor's daily economic dealings, which are characterized by small amounts of money but many frequent transactions. Despite the fact that product fit is difficult to assess and good measurements do not readily exist, it remains an important component of our vision. In a state of full financial inclusion, Mexican providers will offer a diverse range of innovative and valuable services that target various population segments by addressing their specific needs.

Dignity. A final principle of full financial inclusion is that services are provided with dignity and respect for clients. As with any other business, the successful provision of financial services requires careful attention to and respect for the client's concerns. The majority of the financially excluded populations today are low-income individuals. Stereotypes and misconceptions about the poor can sometimes cause providers to treat them differently from other clients. The use of customer-care tools, feedback mechanisms, and market research will allow providers to serve this market with quality.

This dimension also includes the principles of client protection. As we will discuss later, Mexico has increasingly strengthened its level of consumer protection. Two regulations passed in 2007 have marked important steps forward in establishing the legal framework necessary to execute good consumer protection: the Transparency and Financial Law and the creation of CONDUSEF, a public agency providing and promoting financial education as well as responsible for the protection of consumers through complaint resolution. In order to continue this positive trend, more action to solidify the sanctioning powers of CONDUSEF will be needed. Client protection is not just a regulatory issue, however; it is the responsibility of every provider to internalize consumer protection into policies and procedures.

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[16] "Remittance Prices Worldwide," The World Bank Group, http://remittanceprices.worldbank.org/RemittanceCosts/?from=197.

[17] Ibid.

Part II. Taking a Closer Look and Looking Ahead to 2020

A Portrait of the Excluded

An estimated 71 percent of Mexican households are either poor, rural, or informal. Each of these ways of looking at the population highlights specific challenges to financial inclusion, as we will discuss. Of course, the three groups are not mutually exclusive. For example, most of the poor are also informal (Table 4).[18] The bottom 15.5 percent of households that are poor, rural, and informal—the most likely to be excluded and a priority target of the full financial inclusion vision in Mexico.

Table 4. Major Segments of the Mexican Population

(In percent of total population)

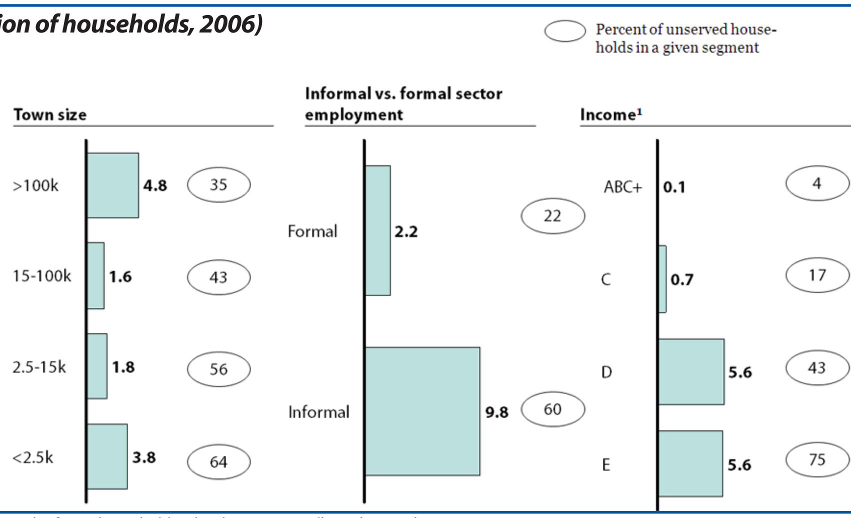
INCOME SEGMENT	INFORMAL		FORMAL		TOTAL
	Rural	*Urban*	*Rural*	*Urban*	
E	15.5	9	1.1	2.3	28
D	10.8	17.3	4.0	17.0	49
A, B, and C	1.5	7.5	1.5	12.4	23
Total	28	34	7	32	100.0

Source: ENIGH, 2006.

The size of a town, informal sector participation, and income are all key determinants of whether a household will have access to any financial services. The poor are more likely than the better-off to be financially excluded, as are those working in the informal sector (Figure 1). Informal workers have less access than their formal counterparts across all town sizes and, rural workers' access lags behind that of urbanites.

Figure 1. Number of Households Unserved*

(Million of households, 2006)



* Unserved refers to households who do not use credit, savings, or insurance.

[1] Ranges for each income band in annual household income (2006 USD) are: ABC+ (24,339+); C(12,099-24,339); D(3,941-12,099); E(<3,941). Source: ENIGH, 2006.

[18] Household formality is inherently challenging to measure. For all of the analyses in this paper, households are classified as formal if at least one member of the household receives a government benefit that typically only goes to people who have formal employment (e.g., government-provided health insurance for formal workers).

Table 5. Penetration of Core Services among Rural, Poor, and Informal Population Segments

	ALL HOUSEHOLDS (% of total HH) 100% = 26.4m HH	RURAL HOUSEHOLDS (% of HH) 100% = 9.1m HH	POOR HOUSEHOLDS** (% of HH) 100% = 20.3m HH	INFORMAL HOUSEHOLDS (% of HH) 100% = 16.3m HH
Life insurance	18	7	12	1
Savings	37	31	31	31
Credit	26	9	16	16
Remittances	7	13	8	10
Access to at least one service*	55	38	45	40

* Access to at least one of the following three: credit, savings, and life insurance.

** Ranges for D and E income bands in annual household income (2006 USD) are: D(3,941-12,099); E(<3,941).

Sources: ENIGH, 2006; FI2020 team analysis.

Among these three underserved populations, usage varies by product (Table 5). In terms of savings, the rural, poor, and informal households are slightly more excluded than the whole nation. However, in terms of life insurance and credit, these three groups lag significantly behind the rest of the nation. The penetration rates also show that these three demographic groups rely more on remittances than others.

How will the State of the Financially Excluded Change over Time?

While Mexico is slowly moving toward full financial inclusion, projections forward of current growth trends suggest that simply doing "more of the same" would not lead to full financial inclusion by 2020, and gaps for the poor, rural, and informal population segments would persist. These analyses are intended to make the case for further action and to deter complacency. Given the numerous challenges associated with projecting future outcomes, these should be taken as illustrative of the work to be done and not specifically predictive of events. While there is much to be done, we and many others believe that there are exciting opportunities for Mexico to move onto a faster path toward full financial inclusion. First, a look at the current trends.

Although Mexico's population will grow by 12 million households between 2005 and 2020, there will be little change in the size of its informal sector (based on 2000-2006 trends) and rural population (based on 1990-2005 trends). Projecting into the future using recent trends, we find that urbanization will decrease the share of the population living in rural areas, but this will not mean formalization; the workforce will remain dominated by informal employment. Even more significant, the actual number of rural households is trending towards an increase as the population rises overall; so is the actual number of informal households (Figure 2 and 3).

Poverty trends in Mexico tell an encouraging story. The Mexican government has prioritized poverty reduction, and the numbers here consider trends without taking into account the significant policy actions implemented by the government. If the 2000-2006 trends persist, the percent of the population living above the poverty line will rise from 50 percent to about 70 percent (Figure 4).[19] Those living above the poverty line generally have better access to financial services. At the same time, because of population growth, the actual number of households living below the poverty line will barely decline, from 11.7 million in 2000 to 10.1 million in 2020.

What is more interesting for our purposes is the dynamic change in the nature of poverty over time. Mexican poverty statistics classify households into three groups based on the depth of their poverty: the assets poor (can afford food with some discretionary income), capacity poor (can afford food but little

[19] These numbers are based only on trends between 2000 and 2006 and do not include the effects of the financial crisis.

Figure 2. Formalization of Mexican Workforce

Percent of total households, 2000-2020

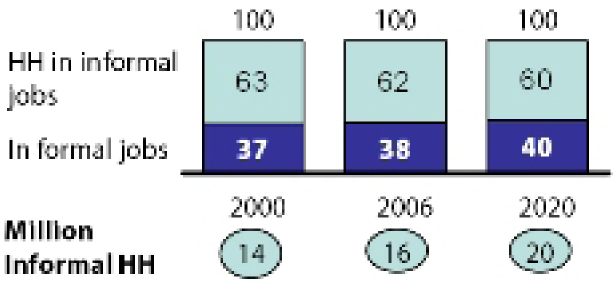
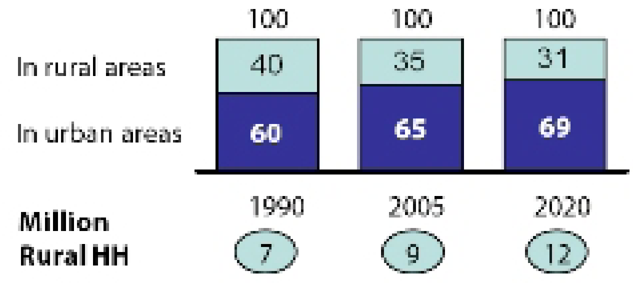


Figure 3. Urbanization of Mexican Households

Percent of total households, 1990-2020

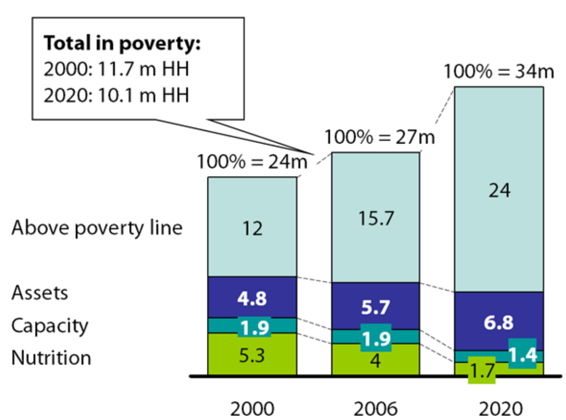


Sources: CONAPO; ENIGH, 2000; ENIGH, 2006; Censo General de Población y Vivienda 1990 and 2005; FI2020 team analysis.

else), and nutrition poor (cannot afford a complete diet). During the next decade many families are trending towards moving out of the deeper levels of poverty into the assets poor category. By 2020, families who cannot pay for basic nutrition are on pace to come down from 5 million households in 2000 to an estimated 2 million in 2020. Meanwhile, the trends suggest that a majority of households below the poverty line will move into the assets poverty category—20 percent of the population or 6.8 million households in 2020. This shift will be important for financial inclusion, as methods for serving the assets group sustainably and at scale, such as microfinance, already exist and can be applied by the private sector. Households in the assets category in particular have some income available to pay for financial services. We will come back to this estimate later, as it provides an important insight into the prospects for financial inclusion by 2020.

Figure 4. Poverty in Mexico

Millions of households, 2000-2020



Sources: SEDESOL; ENIGH, 2000; ENIGH, 2006; CONAPO

We illustrate the risk of business as usual by projecting the 2000-2006 financial inclusion trends forward to 2020 in the same way we projected demographic trends. These illustrative analyses show what would happen if the informal, rural, and low-income population segments continued on rates of inclusion similar to the progress made between 2000-2006 (Figures 5 and 6). These analyses point out that at a pace similar to current rates of inclusion, up to 8 million households could remain fully excluded in 2020.

If the trends between 2000 and 2006 continue, roughly 25 to 38 percent of households working in the informal sector could continue to be financially excluded in 2020 (Figure 5). In towns with populations greater than 15,000 inhabitants, at the 2000-2006 rates of inclusion, nearly all households would be on pace to gain access to at least one financial service by 2020 (Figure 6).[20] However, smaller towns would continue to have 14 to 40 percent of households without access to any financial services.

[20] We applied two possible patterns to the extension of the 2000-2006 growth rate to 2020. The rapid-growth scenario is based on the assumption that the segment will experience exponential growth between 2006 and 2020. In the slow- growth scenario, we gradually lowered the CAGR from the rates in 2006 to 50% of this number by 2020, leveling off growth in use of services. This thought exercise helps to show that current rates of inclusion are not sufficient to solving the problem by 2020. These are based only on trends between 2000 and 2006 and do not include the effects of the financial crisis.

Figure 5. Trajectory on HH use of at least one Financial Service by Formality of Workers

Percent, based on projections forward derived from 2000-2006 CAGR

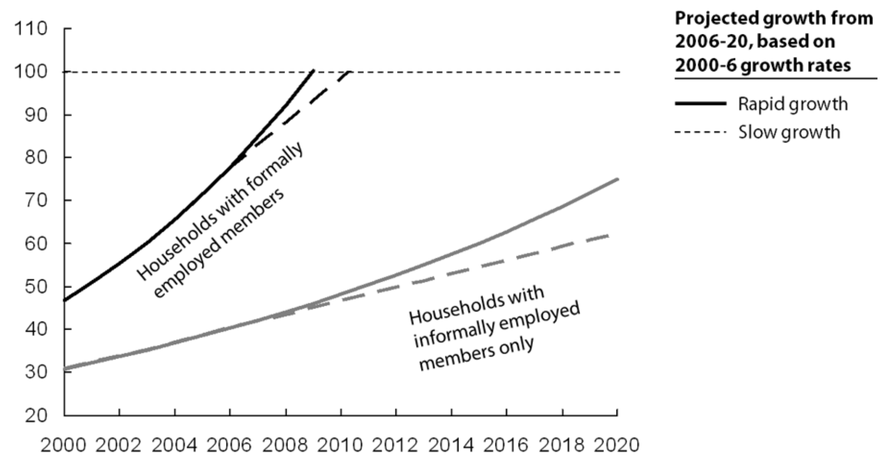
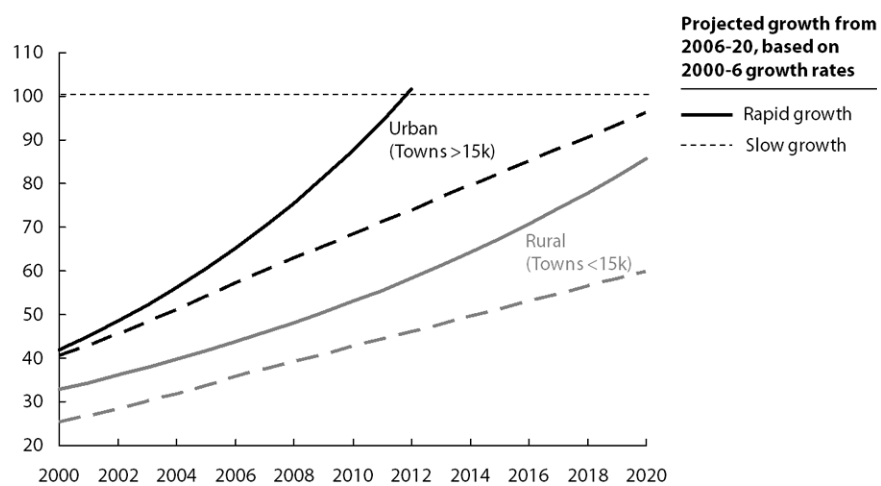


Figure 6. Trajectory on HH use of at least one Financial Service by Town Size

Percent, based on projections forward derived from 2000-2006 CAGR



Sources: ENIGH, 2000; ENIGH, 2006.

In these analyses, rural and informal sectors would continue to have financially excluded households partly because, in addition to starting with lower penetration rates, these two sectors are also gaining access at a slower pace. Figure 7 shows the growth rates of financial inclusion between 2000 and 2006 in the formal and informal sector as well as across towns of different sizes. These two demographic groups will need special focus in order to become financially included by 2020.

If 2000-2006 trends were to continue to 2020, poor households would continue to be the most financially excluded population with the deepest exclusion among the very poorest (Table 6). Applying these trends to 2020, possibly between 63 and 74 percent of the poorest households in income segment E (who make less than US $4,000 per year) could be financially excluded. This is significantly more exclusion than income segment D, where if trends continue, 4 to 34 percent of households could be fully excluded.

Figure 7. Change in the Use of a least One Financial Service

CAGR, 2000-2006, adjusted for population growth

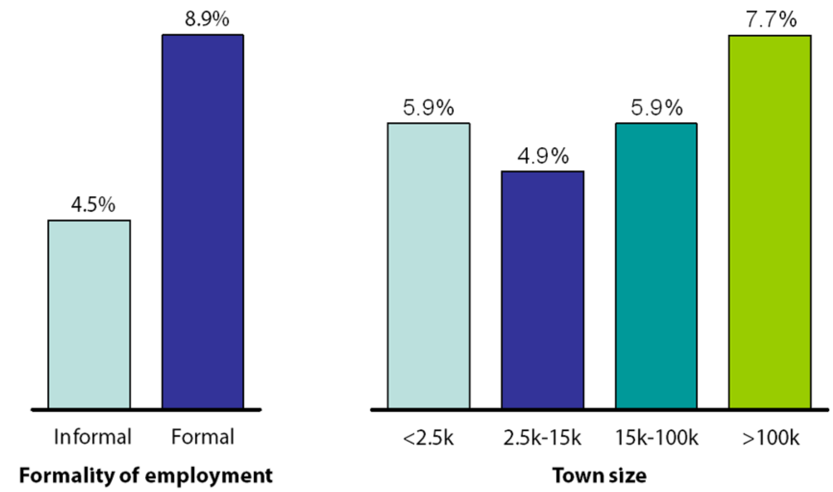
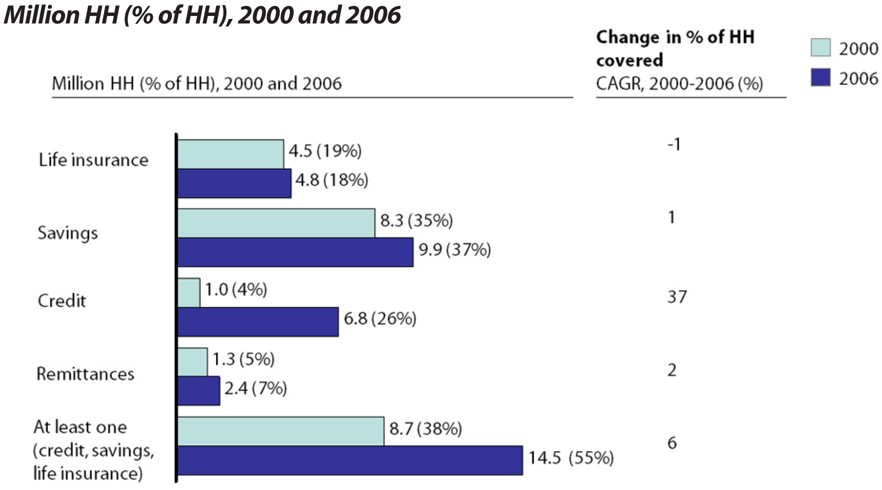


Figure 8. Change in Financial Services Penetration

Million HH (% of HH), 2000 and 2006



Sources: ENIGH, 2000; ENIGH, 2006.

Using the difference in penetration rates of financial services between 2000 and 2006, we considered the rate at which financial inclusion is growing across different services (Figure 8). Between 2000 and 2006, while the absolute number with life insurance increased, the percentage of total households covered actually decreased, because the population grew faster than the rate of penetration. Savings did not increase much either, but its relatively slow growth rate should be taken in context of its high starting point.

It is not certain whether the growth of consumer credit will continue once households in the formal segment are increasingly covered. As shown in Figure 2, Mexico's informal sector accounts for roughly 63 percent of its population, a percentage that is not expected to change significantly over the next decade. It is not clear that consumer credit providers will penetrate informally-employed households at nearly the same rate as they are now penetrating formally-employed households. This suggests a need for different products and lending methods, such as those used by microfinance institutions.

Table 6. Trajectory of Excluded Households in 2020, by Income

INCOME SEGMENT (income range in USD)	TOTAL HOUSEHOLDS IN 2006 (millions)	PERCENTAGE OF HOUSEHOLDS EXCLUDED (%)	ILLUSTRATIVE PROJECTIONS TO 2020 (% of HH Excluded)	
			Rapid Growth	*Slow Growth*
ABC+ (>24,339)	1.8	1.8	0	0
Cm, C- (12,099-24,339)	4.3	4.3	0	2
D (3,941-12,099)	13.0	13.0	4	34
E (<3,941)	7.4	7.4	63	74

Note: "Excluded" means that at least one member of the household has at least one of: savings, credit, or life insurance.

To summarize, our analysis shows that if recent trends were to continue over the next decade, then:

- The number of people in the poor, rural, and informal population segments would not decline much in absolute terms.
- The current growth rate of financial services among these population segments is insufficient to result in their inclusion by 2020.
- The good news is that fewer of the poor will be in the extreme poverty category; the "assets poor" can be more easily reached with financial services.
- While credit is penetrating new markets quickly, other services are not.

Mexico's Banking Landscape and Key Stakeholders

If Mexico is to achieve full financial inclusion, who will provide the services? In this section we turn to Mexico's banking landscape and examine the roles of the key actors. If full financial inclusion is to become reality, the majority of services must be provided by the private sector because it alone has the capacity to operate sustainably and at scale. Other sectors, including the government, NGOs, and cooperatives can play important enabling, experimental, or specialized roles.

The Financial Sector

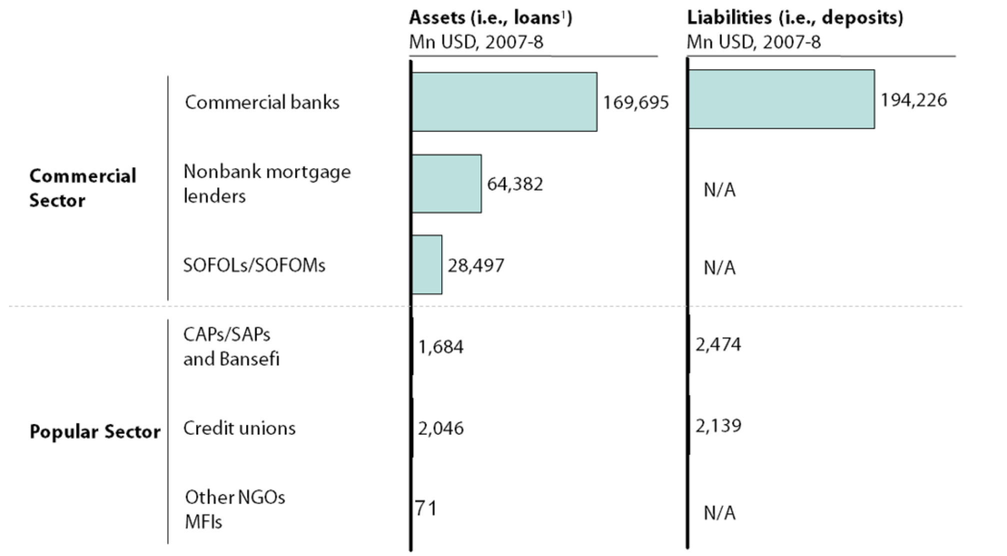
The Mexican banking landscape is dominated by the commercial sector, which consists of traditional banks, non-bank mortgage lenders, and SOFOLs and SOFOMs (specialized lending institutions that cannot take deposits and generally focus on consumer loans, automobile loans, and mortgages)(Figure 9). Together, these three types of institutions lent a total of nearly US $230 billion in 2007, the vast majority of it to the corporate, middle, and upper income segments of the population.

The popular sector has been viewed as the provider to low-income populations. It is made up of cooperatives and credit unions (cajas de ahorro y credito popular) and microfinance institutions registered as NGOs, and it extended US $3.7 billion in loans in 2007. That amount was only 1.4 percent of the amount loaned by the commercial sector. A similar reality exists for deposits. While over US $194 billion was deposited with commercial banks in Mexico in 2007, the popular sector captured only about US $5 billion.

Commercial Banks. Within the commercial bank sector, only seven institutions, mainly international banks, control 88 percent of the market, with US $151 billion in loan portfolio outstanding in 2008 (Figure 10). The other 12 percent is spread among 36 other banks. While a few of the major banks have tested innovative strategies and products for Mexico's financially excluded, most have not yet made these population segments a significant part of their strategies.

Microfinance and Popular Sector. The Microfinance sector has growth potential as well as dedication to the low-income population, including the informal sector. Mexico's Compartamos Banco, the largest and fastest growing MFI in Latin America, is a leading example of the potential of the microfinance sector.

Figure 9. The Mexican Banking Landscape

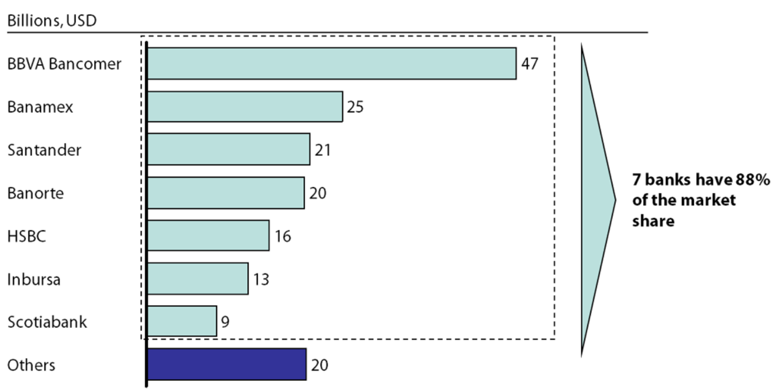


[1] Includes mortgages and commercial and consumer loans; numbers derived from 2007 and 2008 averages.

Sources: CNBV; Banxico; AMFE; Fovisste; Softec; MIX.

Figure 10. Commercial Banks' Market Share

Loan Portfolio Outstanding[1], 2008



[1] Includes mortgages and commercial and consumer loans.

Sources: CNBV.

The microfinance sector in Mexico is also concentrated. Of 41 self-described MFIs in 2007, five institutions accounted for 86 percent of the microfinance market in terms of number of clients. It is difficult to isolate the microfinance sector for the purpose of following its growth, because microfinance institutions use various organizational forms. MFIs take the form of NGOs, cooperatives, non-bank financial institutions (including SOFOLs, SOFOMs, and SOFIPOs), and commercial banks. The top five MFIs include a regulated bank, a non-bank financial institution, two cooperatives, and an NGO. The top two MFIs by number of clients, Compartamos Banco and Financiera Independencia, the latter of which does mainly consumer lending, are in the commercial sector.

This organizational diversity hides microfinance in national statistics (Table 7). Nevertheless, there are commonalities of approach among them all: a focus

Table 7. Top Five Mexican Microfinance Institutions, 2007

MFI	CLIENTS (thousands)	MFI MARKET SHARE (% of clients)	AVERAGE LOAN (USD)	CAGR* (% of clients)	NUMBER OF BRANCHES	ORGANIZATIONAL FORM
Compartamos	839	25	359	44	352	Commercial bank
Financiera Independencia	834	25	347	67	192	SOFOM
Caja Popular Mexicana	779	23	1,485	13	362	Caja de ahorro
Caja Libertad	339	10	1,720	17	110	Caja de ahorro
CAME	106	3	177	12	75	NGO

* Based on number of clients reported. Years that correspond to CAGR are as follows: Compartamos, 2001-08; Financiera Independencia, 2006-07; CPM, 2004-07; Caja Libertad and CAME, 2005-07.

Sources: MIX Market, 2007 data on Mexico; FI2020 team analysis.

on lending to informal sector and self-employed people at the base of the economic pyramid. The diversity of form makes it difficult for regulators to keep track of the performance of microfinance in Mexico or to target the sector with their policies. We highlight the sector here because its growth trends make it a potentially important contributor to full financial inclusion over the next decade and because it constitutes an important body of capabilities for reaching the low-income population. The two largest MFIs have been growing very fast, and many new entrants with similar characteristics have started during the past few years.[21]

Since its inception as an NGO in 1990, Compartamos has demonstrated the potential of microfinance to serve low-income people at scale and profitably. In 2007, Compartamos held an initial public offering with a market valuation of around US $1.56 billion at the time of the sale. The company has maintained a consistent rapid rate of growth. As of the second quarter of 2009 Compartamos reported serving 1.3 million active clients, an increase of 40 percent from the year before, while its total loan portfolio stood at US $445 million. Compartamos' core product is a group loan aimed mainly at self-employed women, a highly excluded group. Compartamos also offers individual loans and life insurance, and it is developing additional services. In 2008, the average Compartamos loan was US $359, indicating its focus on low-income clients.

Non-profit MFIs such as FINCA and ProMujer are present with moderate reach at 113,000 and 17,000 clients respectively. The largest non-profit MFI in Mexico is CAME with about 150,000 clients. These MFIs reach out to very low-income groups with very small average loan sizes. The success of the Compartamos initial public offering in 2007 encouraged numerous new MFIs to enter the Mexican microfinance sector, paving the way for what we expect will be rapid growth in the sector. While these entities are small today, their growth plans are ambitious, and, if realized, they could make microfinance a very substantial contributor to full inclusion by 2020.

Cajas also play a vital role in reaching people who are not served by traditional banks, especially in providing deposit accounts for low-income people. Two of the largest cajas, Caja Popular and Caja Libertad, have been successfully serving and educating Mexico's unbanked. Caja Popular has established 395 branches and serves 1.4 million members.

The government's PATMIR program seeks to expand the capacity of nearly 300 Mexican cajas to serve isolated rural towns with less than 15,000 inhabitants. From 2005 through 2007 the program reached 66,700 households, 47,500 of whom were previously unbanked. It plans continued rapid growth, with the aim that all institutions are financially sustainable within three to five years.[22]

ProDesarrollo, a banking association with 52 affiliated finance and microenterprise institutions, focuses

[21] "Microfinance in Mexico," 2007 data, MIX Market, http://www.mixmarket.org/mfi/country/Mexico.

[22] Gabriela Zapata Álvarez, "Enabling Policies for the Development of Integrated Financial Services in Mexico's Marginal Rural Areas: Lessons from the Rural Microfinance Technical Assistance Project (PATMIR)," SAGARPA, January 2007.

on strengthening institutional capacity, bringing quality services to low-income people, and increasing competition.

The Non-Financial Private Sector

The wide array of players in the private sector includes retailers, telecoms, and payment providers, each of which can advance Mexico's progress towards full inclusion.

Retailers in Mexico have been especially energetic about reaching the base of the pyramid. Retailers' networks of outlets are a strategic asset that can facilitate creative and effective distribution of financial services, such as with correspondent banking. Use of such channels can lower banking costs and provide convenient banking points for the financially excluded.

In some cases, such as that of Banco Azteca, retailers establish their own regulated banks within their own stores. Banco Azteca is the financial arm of Grupo Elektra, the largest specialty retailer in Mexico.[23] Before Banco Azteca was created, Grupo Elektra's four chains were already making over 65 percent of their sales through in-store consumer credit that they provided.[24] In addition, Grupo Elektra also offered savings accounts and wire transfers. Sensing demand and opportunity for providing financial services, in 2002 Grupo Electra created Banco Azteca, a commercial bank. A large percentage of Azteca's customers are new to financial services, and the bank has extended its services beyond the middle-class salaried employees it first targeted into lower income and less formal markets. Because Banco Azteca had preexisting accounts as well as a developed network of stores where it could set up operations, it opened overnight with 815 branches and nearly 3 million active accounts. Today it provides savings, consumer credit, credit cards, life insurance, and remittances distributions, among other services, and serves more than 15 million clients in Mexico.[25]

[23] See Elisabeth Rhyne, *Microfinance for Bankers and Investors: Understanding the Opportunities and Challenges of the Market at the Bottom of the Pyramid*, "Banco Azteca: A Retailer Surprises Mexico" (Washington: McGraw-Hill, 2009).

[24] David Arnold, Gustavo Herrero, Luiz Felipe Monteiro, "Grupo Elektra," Harvard Business School, June 2003.

[25] "Quienes Somos?,"Banco Azteca, http://www.bancoazteca.com.mx/PortalBancoAzteca/publica/conocenos/historia/quienes.jsp.

After the success of Banco Azteca, which today accounts for 11.5 percent of Mexico's bank branch network, other big box retail giants are opening their own regulated financial institutions in their retail stores. Grupo Famsa created Banco Ahorro Famsa in 2007, which by the end of 2008 was present in 277 Famsa stores and had 838,000 account holders, up from 114,000 the year before.[26] A potentially even bigger player is Wal-Mart in Mexico with its creation of Banco Wal-Mart, which could operate through the approximately 1,200 Walmex stores and targeted to reach 3 million clients, most of whom are believed to be financially excluded.[27]

As we will explore later, the replication of Banco Azteca's model will not be enough to deliver full financial inclusion to Mexico. Retailers that offer financial services specialize in consumer lending, and while this movement has been dynamic, it is limited in its reach to the salaried and middle class. More importantly, consumer lenders have often been criticized for poor consumer protection practices. Our vision for full financial inclusion includes providers that actively embrace pro-consumer practices.

Mobile phone operators and other payment providers can also play an important role in advancing full inclusion. Although not typical providers of financial services, they have the unique opportunity to leverage technology and their distribution footprint in order to both reduce costs and to serve clients that are difficult to reach. In Kenya, Vodafone reached 5 million subscribers to its M-Pesa money transfer service within two years.

Government

The government of Mexico demonstrates strong commitment to financial inclusion in a number of ways, including regulation, consumer protection, and support for innovative and experimental approaches to financial inclusion dilemmas.

In the past decade Mexico's government has introduced numerous regulations that can help advance the country towards full financial inclusion. Between 2001 and 2007, the legislature passed several laws addressing

[26] Grupo Famsa, http://www.grupofamsa.com/ING/baf.html.

[27] "Notes on Branchless Banking Policy and Regulation in Mexico," CGAP, March 2009.

microbanking regulation. The law for popular credit and savings required all popular institutions to convert into one of two deposit-taking institutional forms. This has increased the security of savings and the stability of funding for micro-entrepreneurs. A 2003 regulation created FEDRURAL (Federation of Rural Financial Institutions) to work on closing the geographic gap of financial services in rural areas. In addition, in 2007 Mexico passed a law requiring banks to offer free no-frills savings accounts, a salary account with no charges and no minimum balance and a basic a checking account with no charges up to certain limits.

Mexican regulators have also taken seriously the challenge of protecting financial consumers. A federal law for consumer protection created the government agencies CONDUSEF, to address customer complaints. In 2007, The Law for Transparency mandated the disclosure of full interest rates, including fees, helping to increase transparency for consumers. As a result of these regulations Mexico is progressively strengthening its protection of consumers.

More recently, Mexico began to test banking models that can increase access to financial services in rural areas. For example, the government has recently passed a regulation that allows banks to partner with agents, helping to strengthen the emergence of correspondent banking. According to the Consultative Group to Assist the Poor, Mexican regulators are working on regulation that will address matters regarding electronic money provided by non-banks, including mobile payments.[28] Ensuring competition within the telecommunications industry will help promote fair pricing and quality products.[29]

To summarize:

- The Mexican financial sector is highly concentrated, and mainstream financial institutions have not focused extensively on excluded populations.
- Alternative providers have been more instrumental in serving the excluded: microfinance institutions, cajas, and retailers.
- Mexico benefits from a government that recognizes the challenges and attempts, through policy and direct experiment, to incentivize action.

[28] Ibid.

[29] Ibid.

Part III. Opportunities for Progress

Our team has conducted preliminary analysis to identify opportunities to make major advances toward financial inclusion in Mexico. We looked for opportunities that would be financially viable, have potential for scale, and reach important segments of the unserved, such as the poor, informal sector, and rural residents. We focused on areas where recent trends are not currently leading to inclusion. In short, we sought high potential areas where new or additional activities by key actors could help move Mexico significantly toward full financial inclusion. This section is necessarily a preliminary survey. For a full understanding on which to base decisions, each of these opportunities would need to be the subject of its own study, as well as further dialogue among key players.

Part III parallels the Financial Inclusion Scorecard, beginning with access to services, then moving to dimensions of quality—affordability, convenience, product fit, and dignity.

Increasing Access to Services—Close the Location Gap

The data in Part II clearly demonstrates that people living in rural areas receive fewer services than their urban counterparts. Preliminary information on the geographic distribution of bank branches in Mexico shows that about 35 to 40 percent of Mexican households live in towns without a financial services outlet (Figure 11). In fact, 85 percent of Mexican towns with between 2,500 and 15,000 people lack access to a financial services outlet, as do all towns with populations below 2,500. The rural challenge will persist: if recent trends continued, the percent of all households living in rural areas would decline only from 35 percent in 2005 to 31 percent in 2020.[30]

While building branches throughout these underserved towns would provide physical access, in most cases branches are too costly to be financially tenable. Alternative channels in the form of branchless banking provide less costly approaches to closing the location gap. Although numerous constraints remain and have to be addressed, there are three exciting pathways to scale-up branchless banking.

In-Store Retail Banks. In urban areas with retailers like Banco Azteca that have formed banks, nearly 5 million Mexican households lack access to financial services and can benefit from this model.[31] However, it is not clear how much this model will help to reach the excluded populations in small and rural towns. One survey of the leading retail chains found that fewer than 3 percent of all their outlets were located in towns of fewer than 15,000 people, only about 250 outlets in all of Mexico.[32] This is even lower penetration than for bank branches. Only a small fraction of excluded households in such areas are likely to be reached through existing retail chain stores.

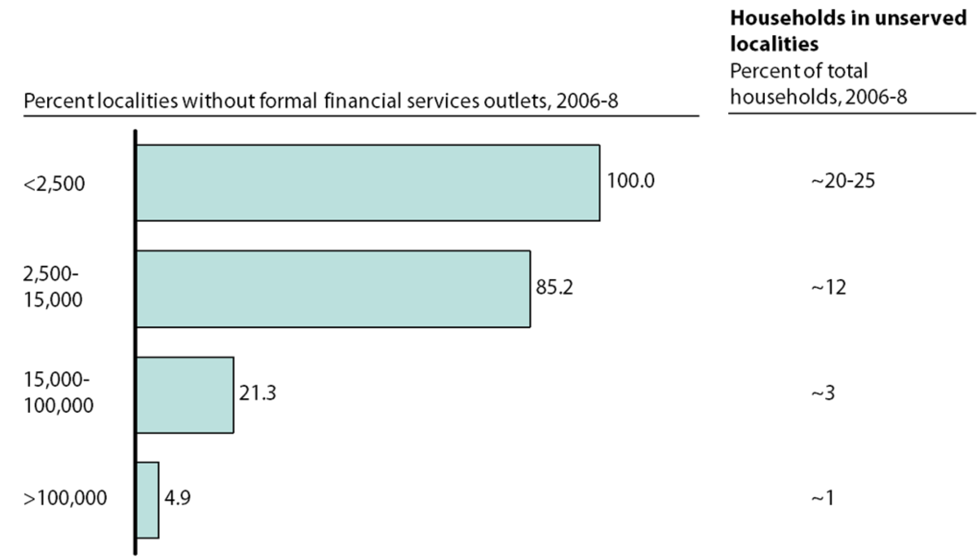
Correspondent Banking/Bank Agent Models. Banks can also leverage existing distribution models by partnering with retailers that can serve as their agents. Because banking agent models can make use of a very wide range of retailers, their reach into smaller communities is potentially stronger than that of the retail chain model. However,

[30] See Figure 3.

[31] See Figure 1.

[32] Source: 2007 data from ANTAD, Mexico's national association of retail stores, with 98 chains that are members: 38 supermarkets, 18 department store chains and 42 specialized chains (include convenience stores). Wal-Mart did not join ANTAD until 2008, and its stores are not included in this analysis. This analysis matches the store locations in ANTAD's database to census data on town size.

Figure 11. Localities in Mexico without any Formal Financial Services Outlets



Note: Includes banks as well as a subset of leading cajas and commercial non-bank finance companies of various forms.
Sources: Asociación de Bancos de Mexico; Bansefi; web pages of MFIs; FI2020 team analysis.

services are typically limited to payments transactions, including deposits and withdrawals. A bank branch still handles setting up accounts and extending credit.

Our initial analysis highlights government-supplied Diconsa stores and Pemex gas stations as potentially promising agents for banks to partner with in delivering financial services to the financially excluded in rural and small towns because of their prevalence in low-income, under-served communities. While there are two bank branches per 100,000 people in towns smaller than 15,000, there are seven gas stations and 56 government stores per 100,000.[33]

Mobile Banking. The third strategy for closing the location gap involves leveraging mobile phone technology to provide mobile payment services. Mobile technology could potentially reach people in the least served areas at the lowest cost of any of the strategies listed here. It could make payments more convenient and less expensive for the vast majority of low-income people for whom transactions costs are major barriers to making regular use of financial services.

Currently in Mexico, mobile penetration rates remain low in the lower-income and rural population segments. As of 2006, of the 9 million households in towns less than 15,000, only a quarter had mobile phones, even fewer than those with at least some access to financial services (38 percent).[34] Mobile phones will need to become more ubiquitous in Mexico's small and rural towns before they can help expand financial access. To achieve that and serve these areas, mobile network coverage will have to be significantly expanded. Hurdles that must be overcome include both the cost of locating cell towers in sparsely populated areas and the challenge of creating financially viable cash handling points in rural areas.

To date, Mexican telecommunications companies have not made dramatic moves to launch payments services for the financially excluded on their own or in partnership with banks. Both Telcel and Telefonica (Mexico's first and second largest telecoms companies) are beginning to consider testing some mobile payment services.[35] In February 2009, Telcel struck a partnership with Banamex to offer mobile payments to the bank's clients who link their mobile number to their bank account. While such a partnership may break important ground, it is likely to benefit mainly Banamex's existing customers.

Before mobile banking can take off in Mexico, further regulatory clarity may be needed. While pay-

[33] Analysis matches data on addresses for Diconsa stores and Pemex gas stations against census data on town size.

[34] ENIGH, 2006.

[35] "Notes on Branchless Banking Policy and Regulation in Mexico," CGAP.

Table 8. Which Channels Show the Greatest Promise for Closing the Location Gap?

ATTRIBUTE	IN-STORE RETAIL BANKS	BANKING CORRESPONDENTS	MOBILE PHONE BANKING
Who provides?	Big-box retailers obtaining banking licenses	Various financial institutions in partnership with large or small retailers	Telecoms companies with or without bank partners
Current scale and status	Massive scale and rapid growth	Model testing; little scale to datel many initiatives	Early experimentation; no significant scale yet
Ability to penetrate unserved areas	Big-box locations reach few towns smaller than 15,000	Could reach very small settlements by use of small retail outlets	Potentially total coverage; but much of Mexico still lacks mobile service
Population segment reached	Formal households; lower penetration among low income and informal	All market segments including low income and informal	Uptake more likely among youth, better educated, and already served
Services provided	Full range: savings, credit, payments, insurance	Mainly payments and savings account transactions, some credit	Payments
Cost reduction potential	Significant, relative to standalone bank brances	Greater, likely deeper thank retail option	Dramatic, once mobile service exists
Current enabling environment	Very supportive	Improving	Significant work needed

ments services such as that of Telcel are currently permitted, the offering of other services, such as mobile savings accounts, is not. The decisions regulators make on these issues will have important impacts on the ability to leverage mobile phones to extend access to a full suite of services to Mexico's rural households.

Comparing Channels. Which of these channels shows the greatest promise for closing the location gap? Each channel could transform the financial inclusion landscape, but they vary in terms of how prepared they are for rapid scale-up, who they reach and what services they provide (Table 8). In reality, a staged roll out of these strategies is likely, with in-store banking already well underway, banking correspondents poised for rapid growth in the next few years and mobile phone banking requiring additional steps to prepare the ground for scale in the latter half of the next decade.

Given the impressive growth rates of in-store banking, this model promises to bring a significant segment of the population into financial inclusion in the near term, especially households in the formal sector and urban areas. Of the three channels, in-store banking offers the widest product range, including all four of our core products (as Banco Azteca has already shown). The main question mark for this strategy is whether it can make a significant difference in the segments that are tougher to serve, especially poor, rural and informal households. Retailers cannot be expected to place stores in very small locations if the volume of business is not there, and financial products designed for the middle class are often unsuited to informal clients.

Banking over the phone has the potential to provide the ultimate level of convenience and maximum geographic coverage, at by far the lowest per transaction cost. But many barriers exist to realizing that potential in Mexico, the first being the extension of mobile phone service in rural areas. Beyond this fundamental prerequisite, business models need to be developed (mobile banking at scale exists today in only few countries such as Kenya and the Philippines), relationships between banks and telecoms companies negotiated, and enabling regulatory frameworks created. Even if these challenges are solved, there is some evidence from other countries that users of mobile phone services tend to be the young and better educated, including many who are already served.[36] This would still leave a gap among the lower-income and informal market segments. And mobile banking has so far focused on money transfers and other payments, rather than a full service range—especially when led by telecoms companies rather than by bank/telecoms partnerships. For all these reasons, in considering full financial inclusion in Mexico by 2020, mobile banking will probably feature during the later years, though foundations need to be laid now.

This leaves banking correspondents as a promising middle route to inclusion. The presence of at least some retail outlets in even very small towns—gas stations, government stores, mom and pop shops, and others—means that physical access points already exist. Because such retail outlets are already used by people of all income levels, the banking correspondent model has possibly greater potential than the other models to reach the informal and low-income population segments quickly. Successful business models already exist, such as those in Brazil, and need to be adapted to circumstances in Mexico, with the support of enabling regulation. The barriers to entry for setting up banking correspondent models are probably lower than either of the other two models, and therefore many different kinds of financial institutions and retail outlets could form partnerships and begin to experiment—as, for example Compartamos Banco has done for loan repayments with Oxxo convenience stores. This would create a vibrant competitive marketplace.

One caveat is that banking correspondent models typically focus on payments rather than full services, but the service range can broaden over time. In sum, we believe that among the three models, now is the time for a major thrust to encourage the spread of banking correspondents, both because it is a model that can deliver scale relatively soon and because it addresses the more excluded market segments.

[36] Amitabh Saxena (channel specialist, Innovations and Integrated Services, ACCION International), in discussions with the authors, September 2009.

Finally, although we have discussed the three models as if they are completely distinct, in fact the greatest power for expanding geographic coverage may well come from combinations of these services, such as, retail banks linking up with telecoms companies.

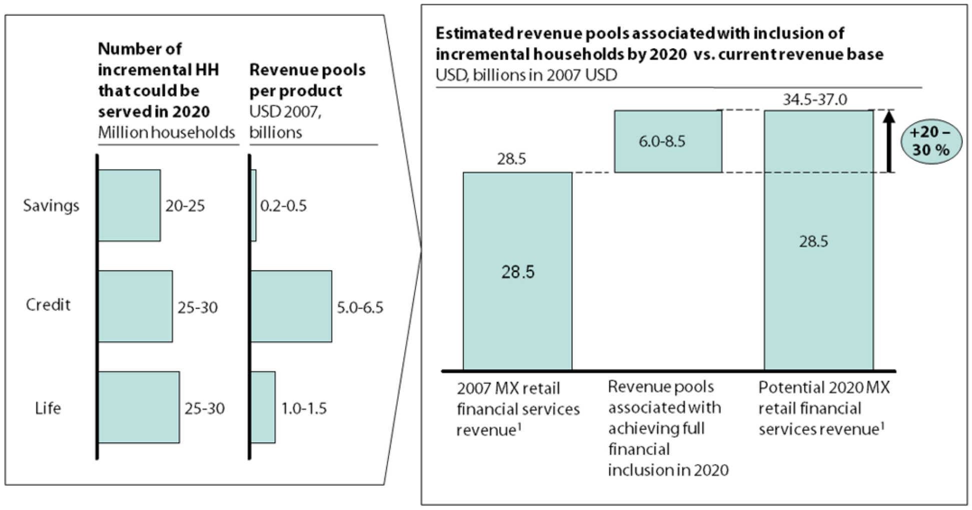
Expanding the Viability Frontier to Reach the Excluded

Many of the excluded households in Mexico today need not remain so, because many could be profitably served with existing business models. For millions of households, technology and techniques exist (for example, microenterprise credit), but have not been applied to their maximum feasible extent, for reasons such as geographic location or lack of appropriate providers. For the private sector, these clients represent an untapped revenue pools. Because financial services matter so much to the lives of low-income people, they are willing to pay for the services, and as we saw in the trends on demographics, if more Mexicans move from extreme poverty to moderate poverty over the next decade, they will become viable to serve as they gain the ability to purchase financial services at rates commensurate with the cost to serve them. Assuming a continuation of current trends, we hypothesize that most of the people who would be in the "assets" poverty group by 2020, 6.8 million households, could become viable clients with existing business models because they have some discretionary income to pay for services.

Poorer and more disadvantaged households may not be currently viable clients for providers; but, with innovations in business models, lower cost structures, and better-designed products, many of them could become financially viable clients. We cannot say at present how big a segment of the low income and rural population is in this category, but the chances are that at least a few million households could be served by 2020 with service delivery innovations that may be on the horizon.

In 2007, Mexican retail financial services brought in US $28.5 billion in revenue. (Figure 12 includes revenue from commercial banks' retail banking activities, all SOFOLs/SOFOMs, and total life insurance revenues.) Achieving full financial

Figure 12. Revenue Pools for Achieving Inclusion



[1] Retail financial services revenue includes all commercial banks and SOFOLs/SOFOMs only; also includes total Mexican life insurance revenue; assumes that there is no incremental revenue growth from current.

Sources: ENIGH, 2000; ENIGH, 2006; FI2020 Team Analysis, McKinsey Global Banking Pools, AMFE, CNSF.

inclusion could generate the equivalent of an additional US $6-8.5 billion in revenue in 2007 dollars, representing a 20-30 percent increase in total banking industry revenue.[37]

Investing in innovations to enlarge the pool of viable clients should be a priority for the public, private and non-profit sectors alike. While the private sector and governments have the resources to invest in experimentation, the non-profit sector has the knowledge of the low income populations, the mandate to reach them and the freedom to launch experiments.

Finally, there will remain population segments that will remain difficult to serve on a for-profit basis, possibly including those in the capacity and nutrition poverty groups and those with special disadvantages such as physical disabilities. Many microfinance institutions have the mission to serve these populations, and government may support their efforts in order to bring important benefits to those in need.

[37] Average household expenditure on financial services was estimated by dividing total Mexican retail banking industry revenue by the average household income of served households (4.1 percent of household income). Based on industry research, modeling of bank cost structure for providing individual products, and FI2020 team analysis, we broke this family spending into weighting within the basket of financial services.

Providing Quality Services

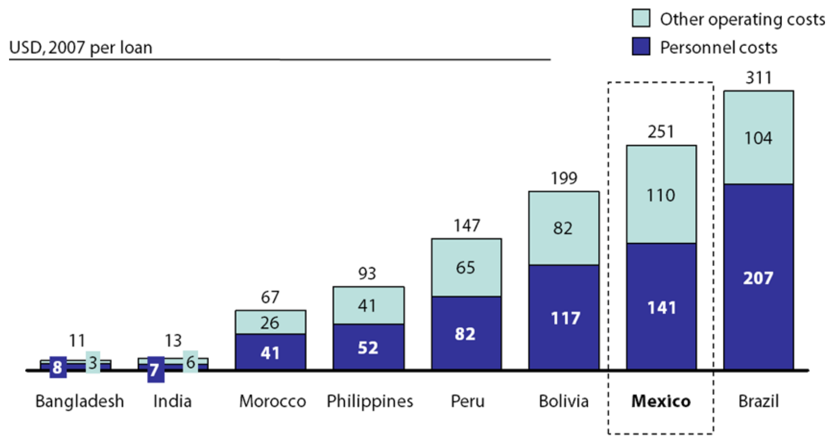
Our vision and the Financial Inclusion Scorecard involve not only access to services but also the quality of the delivery and products. Quality products are affordable and responsive to client needs, and they are delivered in a convenient and dignified manner that allows the client to make the most of the service. Increasing quality reduces the barriers that prevent people from using services even when they are readily available.

Increase affordability

Making financial services more affordable contributes to the quality of access, and at the same time it increases the number of people who can be profitably served. Given the relatively high cost of credit and low value of savings services for clients at the base of the pyramid in Mexico, cost savings should become a high priority.

Value of Savings. The average savings account in Mexico does not retain its value after the rate of return, inflation, and maintenance fees are accounted for. But small savings accounts are expensive to service relative to the amounts saved. The most promising solution involves automating

Figure 13. Cost per Microfinance Loan in Selected Countries



Sources: MIX Market, 2007.

transactions through electronic payments, as discussed below. Another possibility, government mandated "no-frills" accounts can result in the provision of accounts to new low income clients, but if such accounts are not profitable for providers, they will ultimately achieve less than desired results as they will not be promoted or serviced well.

Cost of Credit. The cost of borrowing deserves special attention because it is relatively high for loans to customers at the base of the pyramid. Between 2005 and 2006 retail interest rates in the Mexican microfinance sector ranged between 23 and 103 percent with an average of 68 percent. At the same time consumer credit lenders charged on average 77 percent and the interest on credit cards from traditional banks ranged between 27 and 75 percent with an average of 48 percent.[38] At the same time, Mexico's 2008 average interbank interest rate was relatively low, about 8 percent, suggesting that administrative rather than funding costs are the primary cause.

Various factors affect the cost of providing credit, including labor costs, taxation, and competition among financial providers. Labor costs are often singled out as a cause for higher interest rates by Mexican microfinance providers. Microcredit can be very labor intensive, as it has been based on a "high-touch" business model. Figure 13 compares the average personnel costs of providing microcredit in Mexico to that in other countries. Mexico's labor costs per loan are higher than those in India, Peru, or Bolivia, and on average account for 56 percent of the total cost of providing a microloan.

We note that Mexico is one of relatively few countries in the world that charges a tax on borrowing. This tax, 15 percent of the amount outstanding, is passed on to consumers.

Automation. It is difficult for providers to reduce labor costs, but advances in labor productivity can be attained through automation. With only 17 ATMs per 100,000 people, the potential for cost savings through moving transactions from tellers to ATMs and other forms of automation are likely to be high. High labor costs relative to loan and savings account sizes makes automation an even higher priority in Mexico than in other countries.

The cost savings from non-traditional distribution channels, such as correspondent banking and mobile banking, can range from moderate to substantial. With banking agents, not only does the bank not have to build a new branch, it also decreases staff expenses by exporting transactions to less highly paid agent staff. Mobile banking automates even more of the process.

38 Richard Rosenberg, "CGAP Reflections on the Compartamos Initial Public Offering: A Case Study on Microfinance Interest Rates and Profits," *CGAP Focus Note* No. 42, June 2007, 6.

Product Bundling or Cross-Selling. A different approach to decreasing the costs of providing financial services is to focus on total client profitability by offering multiple products to the same customer. Cross-selling and bundling provide efficiency gains by reducing the internal expenses associated with opening new customer relationships and servicing individual customers. In the case of credit, cross-selling allows providers to rely on data from customer behavior with other products to reduce the cost of credit verification. Retailers like Banco Azteca rely on data from store purchases to inform credit decisions, one of the strategies that propelled Azteca's rapid growth.

In some cases, products can be offered—or bundled —together. Bundling a product that is expensive to deliver but demanded (such as savings) with a product that is relatively inexpensive to provide but less demanded (such as insurance) can help providers sustainably expand access to two services at the same time. For example, the combination of savings and insurance together could provide a modest reduction in the cost to provide the two products while increasing value for customers. A promising form of bundling occurs when government contracts with financial institutions to deliver government welfare or pension benefits through electronic payments that introduce recipients to banks for the first time, as the governments of the Dominican Republic and South Africa have done with Visa.[39]

Increase Convenience

In our Scorecard we identified several areas in which Mexico's provision of financial services is not as convenient as it could be, including the number of documents necessary to open a bank account, the number of days to complete a transaction, and the costs of traveling to the nearest branch. While closing the location gap will help to ease inconvenience surrounding distant branches, closing the former two gaps will require regulatory action and increased operational efficiency.

To open an account in Mexico, clients are required to come into a bank and present several forms of identification. For credit it takes on average 4.4 documents; for a savings account, 2.6 documents (and driving licenses are not acceptable identification). While banks prefer to rely on a voting card and passport many of the financially excluded lack such documents.[40] Mexican regulation allows the use of alternative identification, including third-party confirmation, to prevent identification from becoming a barrier to financial access. However, banks have been hesitant to use these alternative methods for fear of fraud or counterfeiting. Given the open door represented by Mexican regulation, it is hard to understand why banks are not more ready to use this flexibility to reach new clientele.

Our simple survey of providers found that it took an average of 15 days across popular and commercial providers to receive loan approval and 23 days on average to issue a life insurance policy (in both cases, for products that were especially suited to low-income clients without formal collateral or credit history). Both of these are relatively high and inconvenient time constraints. The wait for loan approval can discourage the use of formal financial services in the face of immediate credit availability from informal providers. Increasing back-end efficiency and in some cases decentralizing decision making (through automatic loan approval tools) could help decrease the wait and increase the use of formal financial services.

Improve Product Fit

Although our Scorecard focuses on basic, plain vanilla financial services, an opportunity exists for providers to increase develop new products range tailored to the still-unmet needs of specific clientele. Such products bring clients new value, addressing the latent demand that exists within financially excluded households. This allows providers to tap into new revenue pools at the base of the pyramid. Although our Scorecard does not measure product fit, we look at ways to develop this dimension of quality through examples of Mexican providers who have created services that fit the needs and lifestyles

[39] See Elisabeth Rhyne, Microfinance for Bankers and Investors: Understanding the Opportunities and Challenges of the Market at the Bottom of the Pyramid, "Visa: Social Benefit Systems That Benefit Everyone."

[40] "Notes on Branchless Banking Policy and Regulation in Mexico," CGAP.

of previously excluded populations. Opportunities exist in areas such as health insurance, housing finance, and education finance, to name some of the most important.

Life insurance represents an area where some progress is evident. More than other services, insurance products need to be redesigned to bring value to the excluded. The insurance needs of the poor can be drastically different from those of the middle and upper classes. For example, unemployment insurance does not meet any demand for the roughly 17 million Mexican households operating in the informal sector. Conversely, livestock or rainfall insurance could address needs of the small farmers who operate in the informal sector. The vast majority of life insurance is group insurance, not individual, making it less accessible for those working in the informal sector.

In 2007, Paralife, a Swiss microinsurance provider, launched operations in Mexico. Paralife provides life insurance to disabled individuals, low-income people, and micro-entrepreneurs by leveraging the distribution channels of MFIs and consumer retailers. For small MFIs the policy is simple, providing insurance for a five-year term either with a single premium or through a savings account. This one-size-fits-all policy makes it cheap and simple for small MFIs to offer insurance to their low income clients—something they could not do with traditional insurance products. In MFIs with more than 10,000 clients or large scale retailers, Paralife customizes its products to address more specific needs.

It is has been estimated that up to 30 percent of Mexico's population can be served with such an insurance policy, and with only two years in existence, Paralife has approximately 200,000 clients.[41] Paralife plans to expand its offerings of to include health, education, mortgage, property, and catastrophe insurance.

Promote dignity through consumer protection and financial literacy

The final dimension of quality in our vision for full financial inclusion demands that clients be treated with dignity. The comfort necessary for a transparent interaction comes through respectful and dignified treatment of the client. When clients interact with providers in such an environment they are unafraid to ask about the terms of the service they are receiving and about the responsibilities of both the provider and the client in the transaction.

As articulated by the Campaign for Client Protection, a microfinance industry effort to increase implementation of client protection principles, financial inclusion should incorporate strong client protection elements at every step.

We focus here on transparency as a cornerstone of client protection. Transparency includes informing clients about credit interest rates – which Mexico's regulations laudably already require. More than this, however, the broad concept of transparency suggests that clients and service providers need to be in full and open communication about the services on offer. This in turn requires clients to be informed and educated enough to understand how to make the most of financial services.

As mentioned previously, Mexico's government has established CONDUSEF with the responsibility of protecting financial clients by reporting consumer complaints, strengthening institutions' reporting on consumer treatment, protecting client privacy, and imposing sanctions on institutions that fail to respect consumer rights. Regulators have been considering strengthening the role of CONDUSEF by giving it both "teeth" and more responsibility for financial education.

The Six Principles of the Campaign for Client Protection in Microfinance

Avoidance of over-indebtedness

Transparent pricing

Appropriate collections practices

Ethical staff behavior

Mechanisms for redress of grievances

Privacy of client data

www.clientprotectioncampaign.org

[41] "ParaLife; Summary of Proposed Investment," IFC, June 2009, http://www.ifc.org/ifcext/spiwebsite1.nsf/1ca07340e47a35cd85256efb00700cee.

Table 9. Comparative Advantages and Motivations of Various Actors

COMPARATIVE ADVANTAGE	TRADITIONAL BANKS	MFIs AND CAJAS	RETAILERS	TELECOMS	INSURANCE COMPANIES	GOV'T AND REGULATORS
Know-how in financial services	YES	YES			YES	
Connect to low-income /excluded clients		YES	SOME	GOOD		
Close location gap			YES	POSSIBLY		
Reduce the cost of services			YES	YES		
Increase the value of products	YES	YES	YES	YES	YES	
Provide financial literacy	YES	YES			YES	YES
Transparent client interaction	YES	YES	YES	YES	YES	YES
Enabling policy						YES
INCENTIVES	Tap revenue pools; build long-term market of new customers	Improve lives of low-income people; fulfill mission	New prodcuts, in-store traffic, and increased purchases	New products, increased mobile usage, subscriber loyalty	New products, more policy holders, risk diversification	Increased social justice and civil participation, possible decrease in poverty

Another Mexican group that plays a role in expanding transparency through financial literacy is Prodesarrollo, a network of 46 affiliate MFIs, NGOs, cajas, and banks that together served over 1.3 million low-income clients in 2007.[42] The network uses financial literacy campaigns, employee incentives, and assessments of consumer satisfaction to promote financial education throughout its own network and the industry as a whole.

Some providers in Mexico have also helped to promote financial literacy within their own daily operations. Compartamos for example requires a month of training for all of its solidarity group clients, in which the borrower groups meet together weekly for financial training and to practice loan repayments. Each borrower brings her "repayment" each week, which is put aside as a deposit in a savings account. This practice helps clients understand how the process works before they begin to borrow.[43]

Governments and popular sector providers are not the only ones with the responsibility—and opportunity—to ensure that clients are well educated. Traditional banks and insurance companies can also take steps to provide clients with knowledge necessary to make the most of a financial service. In specific, providers can set up feedback and complaint mechanisms, such as hotlines, where clients can seek out advice and answers regarding services. They can also train staff to be thorough and clear with clients,

[42] FOROLACFR Portal: Foro Latinoamericano y del Caribe Finanzas Rurales http://www.forolacfr.org/

[43] Cara Forster (program manager, Double Bottom Line, Center for Financial Inclusion), in discussions with the authors, August 2009.

Table 10. Toward Full Inclusion in 2020: Opportunities, by Actor

ACTOR	NEAR TERM	MEDIUM TO LONG TERM
Traditional Banks	Reduce costs to serve by automating transactions Form allinaces with and learn from microfinance institutions Set up banking correspondent relations	Develop know-how to serve low-income and informal clients Scale up sesrvices to the underserved
Microfinance Institutions and Cajas	Sustainable growth, to reach many more low-income, informal clients Form partnerships to bring wider product range to clients Reduce cost through efficiency	Reach out to teh remaining excluded Push the "viability frontier" to develop means of serving poorer and more remote clients Provide financial literacy training
Retailer Bankers and Consumer Lenders	Expand from consumer credit to a wider range of financial services Enter banking correspondent arrangements Become champions of client protection	Penetrate smaller towns Seek ways to serve informal clients
Telecoms Companies	Extend mobile services to all parts of Mexico Work with regulators toward an enabling environment Begin testing business models	Roll out business models Solve inter-operability challenge to make services more valuable Expand product range
Insurance Companies	Innovate in both product simplification and delivery channel use Scale up basic life insurance for BOP clients	From life insurance expand to a wider range of insurance- e.g. health, disability, property
Government and Regulators	Ensure that regulations facilitate alternative delivery channels Continue stregthening client protection Support frontier-pushing experiments	Maintain enabling environment up to date as technology and industry evolves Monitor progress toward full inclusion Support efforts that reach still-excluded segments

taking the necessary time to answer a question. Such actions will not only benefit the client's experience with a service, but will help providers build and retain customer loyalty.

Conclusion: Who Will Drive Financial Inclusion?

As we now look forward from analysis to action, attention naturally turns to the question of "Who?" Who will drive inclusion, and what actions will make the most difference?

For the opportunities described above to form a path towards full financial inclusion it will take actions and alliances across different types of private actors, microfinance institutions, the public sector, and policy makers. Realization of full inclusion will require partnerships and cooperation among players, in addition to unilateral actions. Table 9 summarizes the key strengths and incentives that shape the roles of various actors.

To realize the advantages of expanding access, providers must align their strengths with partners who balance their weaknesses. Regulators can facilitate multi-actor approaches through enabling policies and regulatory incentives.

For example, our preliminary analysis indicates that a high potential way to provide services in rural areas could combine correspondent banking through gas stations with mobile phone services. Gas station personnel would become banking agents as well as cash-in/cash-out points for mobile payments. Developing such a delivery method would require the coordination of actors in banking, telecoms, and retail, all facilitated by supportive regulation. Such collaboration could benefit all parties including clients. Banks would gain new clients and tap into the US $6 - $8.5

billion revenue pools at the base of the pyramid. The gas stations that serve as banking agents would experience increases in traffic and even sales, as some customers would use their cash in the station's shops. In a pilot of correspondent banking across several stores in rural Mexico, sales were found to increase by up to 30 percent as a result of the stores' new role as banking agents. A telecoms company that joins the collaboration by offering mobile payments could reach new subscribers and gain access to gas stations that could serve as cash in and cash out points for its service, reducing its own costs of establishing such points.

We close this wide-ranging look at possibilities to achieve financial inclusion with a summary of opportunities for action by each group of main actors, from microfinance institutions to telecoms companies to government. Table 10 is by no means comprehensive; rather, it draws attention to some of the best opportunities in the short run, as well as areas that will become more important in later years. The table contains some of the key ingredients for a national financial inclusion strategy, and we offer it here as an opening to further exploration.

A Final Note

In the past decade, Mexico has undergone great changes that have contributed to its economic growth and integration into the global economy. Yet inequality and poverty within its borders continue to exist. Despite the remaining unmet need for financial services in Mexico, great potential to close the gaps is already present in the innovations and achievements of the private, non-profit and government sectors. We believe that Mexico can achieve full financial inclusion by 2020. We have presented this multidimensional look at Mexico's status and prospects with the hope of contributing to a broad ranging discussion among the participants in inclusive finance. While these are complex challenges, full financial inclusion can help create more equal opportunities for all, allowing all Mexico's citizens to share in the nation's progress.

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THE CENTER FOR FINANCIAL INCLUSION pursues the proposition that low-income people deserve high-quality financial services and that these services can best be provided through commercial models that incorporate social purpose. The Center works on behalf of the microfinance industry as a whole, serving as a bridge to leverage private sector interest in microfinance. In collaboration with others, the Center works to bring the best minds and expertise to bear on industry problems. We are outcomes-focused, setting specific goals and measures of accountability for real-world change.

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