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Debunking myths about financial tools for the Base of the Pyramid:

a case study from 17 micro-entrepreneurs

Financial inclusion matters for economic development. In April of 2015, the World Bank reassured its commitment to accelerate access to financial services globally, and along with private sector partners announced its Universal Financial Access 2020 goal: the aim is to allow 1 billion people to gain access to formal financial services. In Mexico alone, the World Bank estimates that in 2014 there were 54.3 million unbanked adults, and hence the potential benefits of financial inclusion is wide.

However, there are common misconceptions about the behavior, knowledge and alternatives of those people that are excluded from formal financial services. For different reasons, it is difficult to find complete, reliable information about marginalized families. It is sometimes difficult to access these communities; for safety reasons, some people avoid gathering information in the toughest neighborhoods; and because of lack of trust, people sometimes do not want to answer questions, prefer not to be interviewed, or simply might not give honest interviews. All of this means that there is limited information about excluded families, and thus there could be misconceptions about how they behave, how they work and how they manage their businesses and resources.

Through this case study, we shed some light on how micro entrepreneurs use formal and informal services for borrowing and saving, and we help debunk some common misconceptions. While some families do have access to formal services, others have to look for alternative, unusual financial tools for them and their businesses. We spoke to 17 micro entrepreneurs from Iztapalapa, a marginalized urban neighborhood in Mexico City with high poverty and crime rates.

Having more information and a better understanding of those that financially excluded can help in **designing solutions that are tailored for them**, and thus the potential benefits from financial inclusion can be maximized.

Tenoli Insights, experts on International Development, creates and delivers indepth reports with new, holistic and reliable data about peoples at the Base of the Pyramid, their families and their businesses.

About Tenoli

Tenoli, founded in 2014 by two Harvard graduates from International Development, is a social business that modernizes and empowers mom&pop shop owners through technology and education.

Tenoli opens modernization centers directly in marginalized urban communities, where every day they are in touch with micro businesses, their families and their clients.

It is this high level of trust that Tenoli developed in these communities that allows them to generate holistic, reliable and deep information about marginalized families.

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Jessica and Azucena talk to Raúl about his access to and use of financial services.

MYTH 1

BoP entrepreneurs do not know or do not understand their financial options

This is a common misconception that we found not convincing. On the contrary, mom&pop shop owners have a wide experience using diverse financial tools to manage their savings and access credit. They use them regularly and intensively. BoP entrepreneurs tend to have little access to formal credit instruments. But it is precisely because of this exclusion that they need to come up with alternative instruments to overcome financial constraints. When we open the lens of our research to capture these alternative instruments, then we can learn that most of these entrepreneurs are finding and using different tools at the same time. In fact, on average, these micro-entrepreneurs used 2.8 instruments for credit, and 1.1 instruments for savings, and only one out of the seventeen entrepreneurs was not using any financial instrument.

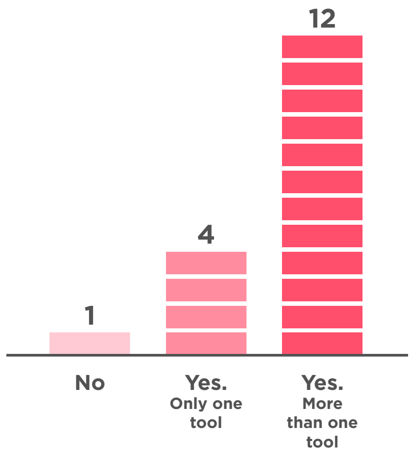
On average, our micro-entrepreneurs used 2.8 credit tools, and 1.1 savings tool.

16 out of 17 used at least one credit tool, and 12 used more than one credit tool.

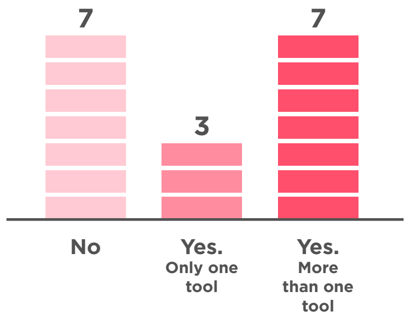
10 out of the 17 used at least one savings tool, and 7 used more than one savings tool.

Only one of the respondents did not use any financial instrument.

Used credit tools?

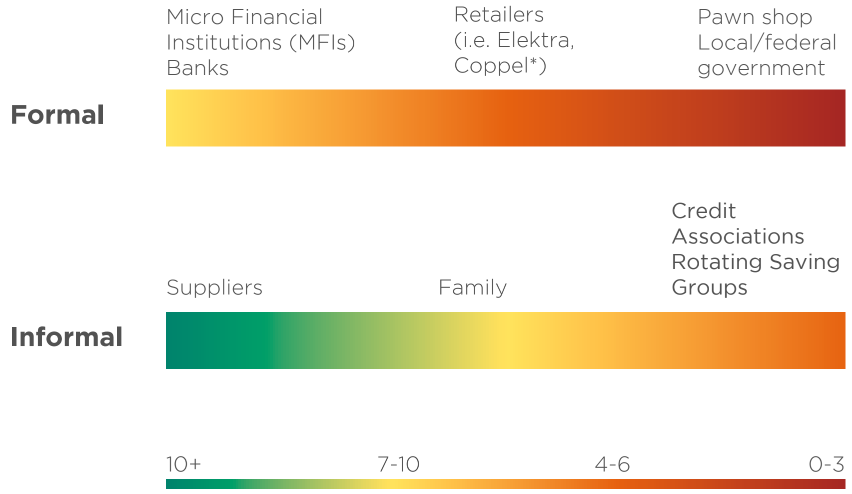


Used saving tools?



Not only do BoP entrepreneurs understand what their financial options are, they also use both conventional ("formal") and unconventional ("informal") tools. Micro-entrepreneurs obtain financial services from various registered and unregistered – formal and informal – providers. The National Banking and Securities Commission (CNBV), Mexico's main financial regulator, considers formal providers those who are registered and whose main object is to provide credit financial services.

Main Providers of Financial Services



*These retailers began their operations by selling products in deferred payments but have evolved into creating their own banks that are regulated financial institutions.

Why does this matter?

Access to formal financial services can have a positive impact on development if the products offered address specific needs of different sectors and are provided at a lower cost. Financial inclusion efforts should target specific gaps in financial services.
Banks and governments have invested large amounts of money in financial education programs. However this investment might not reap adequate returns if the products offered do not match the variety and flexibility that BoP users require. It is important to understand the advantages and disadvantages that owners of traditional businesses consider when they make financial decisions.
Another interesting trend observed in the survey is that financial institutions do not represent the main source of credit in this sector. Financial inclusion studies and initiatives that only focus in formal services might be missing an important part of the picture.

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MYTH 2

BoP entrepreneurs do not save

Bank deposits and saving accounts are not widely used among this sector. According to some of the owners we interviewed they are expensive, inconvenient and perceived as a security risk.

However, most of the respondents engage in some kind of saving activity including setting some money aside (guardadito), or invest in informal saving and credit groups. The most popular tool is the rotating savings association, known as tanda. Our entrepreneurs commit an average of $1,960 MXN ($98 USD) every month to a tanda. Each month, a different member of the tanda receives all of the resources collected. This goes for different number of months until all members have received their payout. Usually, the number of members in a tanda is 12, the same number of months in the year. This allows each member to receive a large amount of money at once. Many cited the exercise of social pressure as the best incentive to save.

Other popular tools for savings are informal credit associations known as cajas de ahorro. These associations work as a traditional bank that provides both savings and credit products for their users. According to the respondents, they offer an average of 11% rates of return for an average deposit of $6,625 MXN ($331 USD). An interesting lesson is that our micro entrepreneurs were well aware of what the interest rate was, and were able to give us a straightforward answer, without hesitation, when we asked them what the interest rate on their savings was.

Why does this matter?

According to advocates of financial inclusion, a broader access to bank deposits is beneficial for financial institutions as it can make the funding base of banks more resilient in times of financial stress. However, efforts to increase savings accounts have focused in the digitalization of payments, leaving the self-employed underserved. Formal institutions could use information about the services that this segment of the population considers useful and trustworthy to replicate similar experiences and provide greater benefits.

The amount of credit that BoP entrepreneurs can manage is limited

MYTH 3

Our survey revealed that mom&pop shop owners have important capital requirements to cover both household and investment needs. Different credit options are widely used to supplement their income.

Table 1 Credit tools used by our entrepreneurs
Amounts in pesos (MXN) and US dollars (USD)

Type of credit	Average amount (MXN)	Average amount (USD)	Number of users
Revolving supplier credit	$1,440 weekly	$72 weekly	13
Microcredit	$14,000	$700	8
Retail credit	$8,250	$412	6
Family loans	$5,125	$256.25	5
Pawn shops	$5,000	$250	4
Personal bank loan	n.a.	n.a.	4
Housing credit	n.a.	n.a.	3
Car loan	n.a.	n.a.	1
Credit card	$2,700	$135	1

n.a. Not available
As a reference, the average monthly income in Iztapalapa is $3,800 MXN ($190 USD) per capita (INEGI Mexico)

A closer look into mom and pop shop owners' credit needs

Paty – uses informal tools more intensively

Paty opened a small shop five years ago. She does not have a bank account and has never obtained a loan from a bank or a MFI. She has relied on supplier credit, family members and social groups instead to maintain her business afloat. She owes $13,000 pesos ($650 USD) to a family member and has invested $5,000 pesos ($250 USD) in an informal credit association with an 8% return. This week she took $2,500 pesos ($125 USD) in short-term credits from her suppliers, which will have to be repaid in one week. P has used credit from retailers like Elektra and Coppel to purchase various household appliances including a refrigerator, a stove, a washing machine and a phone. She currently owes $18,000 pesos ($900 USD) from those purchases.

Alejandro – uses formal tools more intensively

Alejandro owns a shop where he works along 2 other employees. He has a savings account in a bank and a debit card. He obtained a credit to invest in his home and recently obtained a loan from Banco Compartamos for $20,000 ($1,000 USD) to invest in his business. This week he took $1,300 pesos ($65 USD) in short-term credits from his suppliers. He also owes a family member around $3,000 pesos ($150 USD).

Why does it matter?

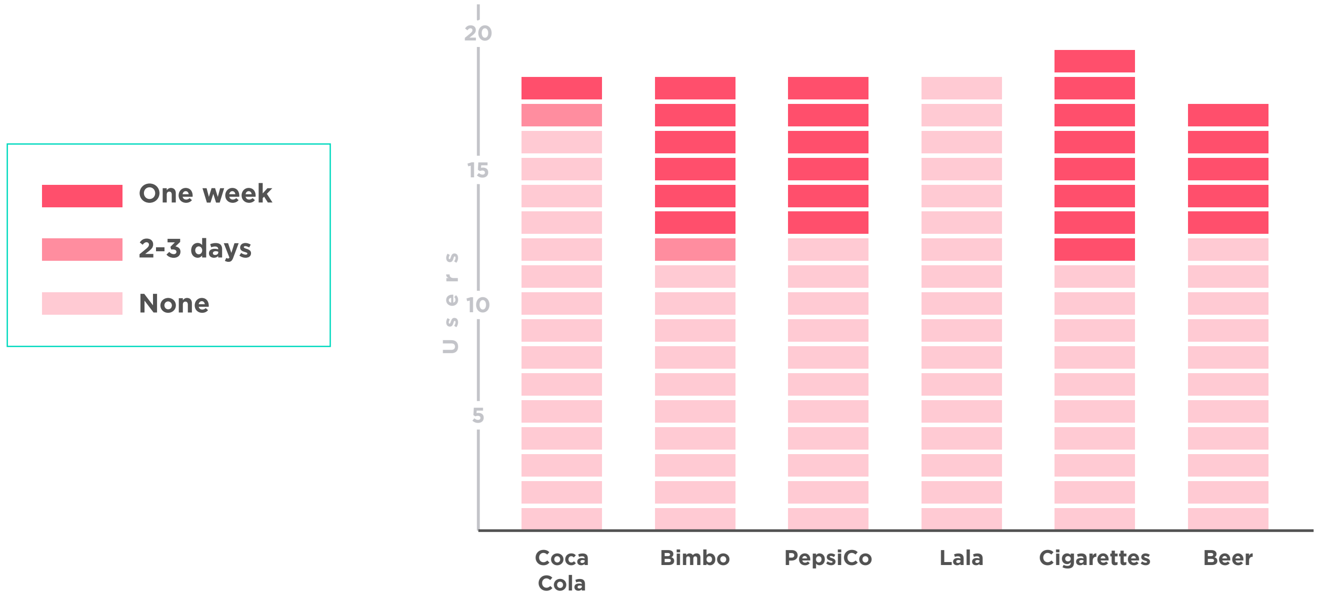
Formal institutions have underserved the BoP sector, as it has not been seen as an income-generating opportunity. However, there could be enormous opportunities for the private sector from financial inclusion. For example, throughout the country there are 850 thousand traditional mom&pop shops. Many of them might be similar to Paty, above, who was able to manage different credit lines that amounted to $33,000 pesos ($1,650 USD). Individually, the amount is small, but if scaled to a very large number of similar businesses, then the potential market is huge. In fact, Compartamos Banco, the largest micro finance institution in Mexico reported Net Income in 2014 of $3.1 billion pesos ($155 million USD), and a loan portfolio of $23.9 billion pesos ($1.19 billion USD).

MYTH 4

BoP entrepreneurs will use credit only for consumption goods

The most common credit tool among our entrepreneurs is supplier credit to finance working capital. 13 out of 17 store owners used revolving credits from Fast Moving Consumption Goods' (FMCG) companies to purchase inventory. Suppliers tend to charge a small fixed commission for this service (ranging from $2 to $10 pesos per transaction; that is $0.10 – $0.50 USD). The price is relatively low because FMCG companies can guarantee payment back by conditioning future distribution of products. These credits are paid on a weekly basis.

Supplier credit



Why does it matter?

Financial services for the BoP have been built around the demand for consumer goods. For example, the past decade has seen the emergence of multiple financing options from retail stores targeting this segment. According to this evidence, there is still an important credit gap to finance working capital that could signify a window of opportunity for financial services in this sector. The supplier credit model can be used to create formal financial tools, and provide information about these businesses average sales, repayment rates and general credit worthiness.

Where do we go from here? Tenoli's financial inclusion initiatives

We are looking for partnerships to develop more comprehensive reports that delve deeper on financial inclusion, and promote alternative solutions for the Base of the Pyramid

Create products that address our clients' financial needs. We are currently working on a digital marketplace to connect our clients with a wider variety of suppliers. This marketplace will facilitate orders and distribution and will give smaller producers an entry to this market. This is a good opportunity to introduce an e-wallet that incentivizes online shopping. Revolving credits might be a useful tool to meet these objectives.

Generate and analyze data about specific products that help banks, MFIs and FMCG businesses to understand and access this market.

Expand the network of stores that work as correspondents for the payment of services and the reception of remittances.

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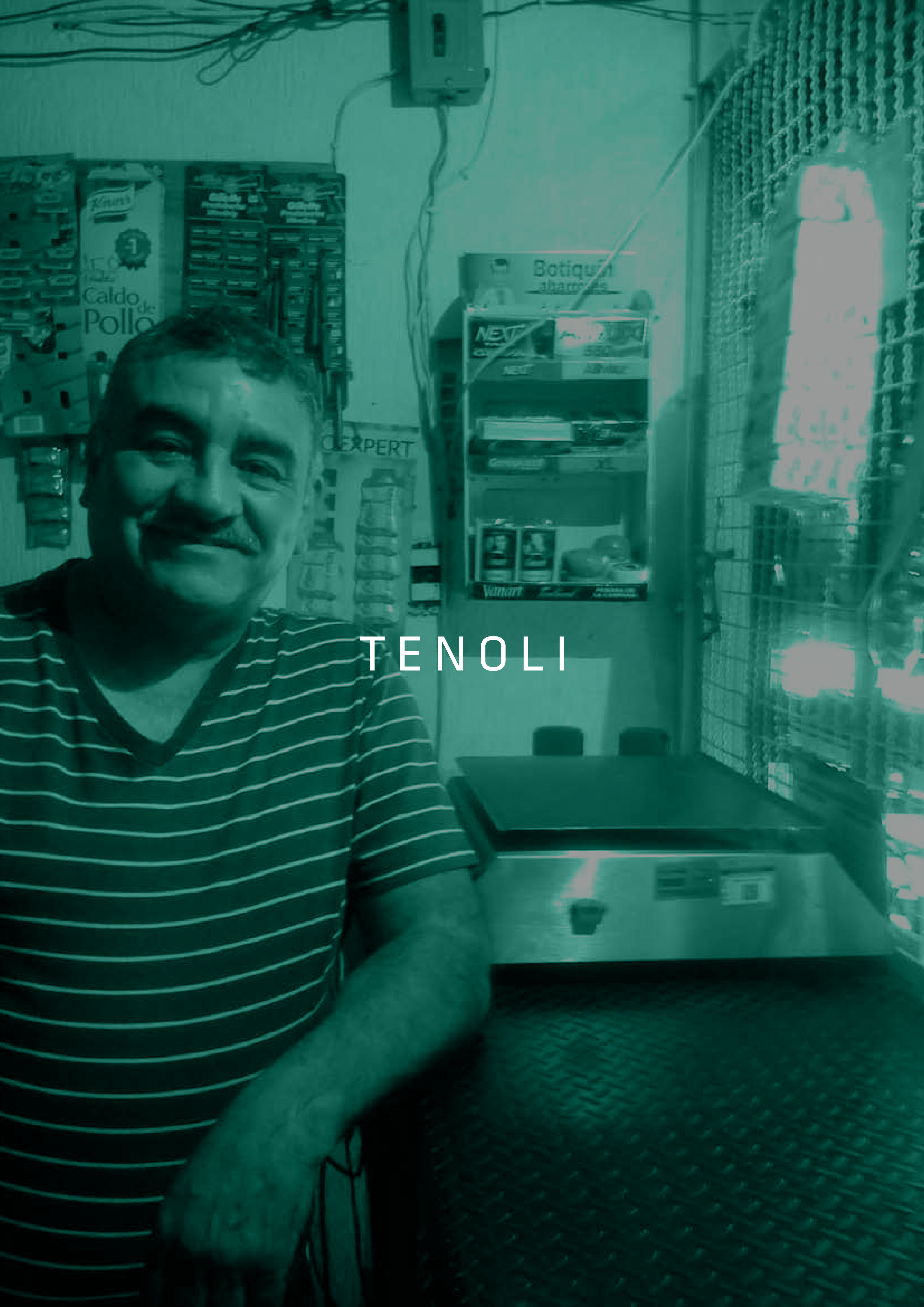

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