

What Works

Lo Pequeño Es Hermoso (Small is Beautiful) Banks in Mexico say that microloans are helping the poor while boosting their profits

By Ricardo Sandoval

Stanford Social Innovation Review
Fall 2005

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Maria Sanchez (center) and her two daughters look out the window of a home she purchased with a SOFOLES loan.

Once a week, Maria Celia Sanchez Correa visits a construction site on the outskirts of Mexico City where her two-bedroom, one-bath condominium is being built. For Sanchez, a 51-year-old single mother working as an administrative assistant at Mexico's Supreme Court, this will be the first house she's ever owned. Sanchez pays about \$200 a month – deducted from her monthly salary of about \$1,300 – to pay for her new home. Over the 30 years she'll need to pay off her loan, the original cost of the condo, \$35,000, will have ballooned to over \$75,000, but she doesn't mind.

"There is no other way I'd have ever owned my own home," Sanchez explained recently, as she sat in the cramped

apartment she now shares with a grown son and daughter. "This is a great thing the government is doing for those of us who are overlooked by banks," she added.

Sanchez is referring to her status as a customer of a Limited Purpose Financial Partnership – ventures known by the Spanish acronym SOFOLES. These targeted mortgage banks are among the weapons being employed by governments in developing nations to lure private enterprise into extending business and housing credit to communities traditionally ignored by banks.

The core motivation for the financial institutions involved in the SOFOLES is not altruism. They see what other opera-

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tors of microcredit funds have been seeing for a while now: Despite expectations, poor people are reliable in repaying loans, and they don't mind repaying them with interest.

Pent-Up Demand

In Mexico, about half of the population lives on less than \$2 a day in formal income; others live on incomes augmented by informal, untaxed work, as well as on the contributions that each year arrive in Mexico from migrant workers abroad. (See "Local Heroes," p. 51.) All of that, combined, fuels demand for nontraditional forms of credit in communities that until recently have been shut out of the formal economy.

"The SOFOLES were the spark," said Fernando de Abiega, a real estate broker who has seen the low-frill mortgage market grow into the middle class in Mexico. "They became the first-step bank, with government limits on the amount of money that could be loaned to any one person, but they have worked. We've seen them become a good business."

Part of what is fueling the growth of the SOFOLES is the growing body of evidence of a strong repayment rate on small loans to the poor. That was one of the big surprises for a group of professional women at the Dallas-based Haynes and Boone law firm who signed on as co-sponsors for Al Sol, a microlending program designed for women in indigenous villages in the southern Mexican state of Chiapas.

Since 1998, Al Sol has issued 15,754 loans, averaging \$159, to some 5,000 women who have started everything from crafts cooperatives to chicken farms and even street corner chewing-gum ventures. To date, a remarkable 98.9 percent of the loans that have come due have been successfully repaid.

"The rate of repayment on schedule is impressive, and I believe it's because the women know succeeding at one loan level makes them eligible for a larger loan at another level," said Noel Hensley, a securities litigator and partner at Haynes and Boone who advises the Al Sol project. She has become a true believer of the transformative power of carefully planned and monitored microlending.

"It's empowering. It's loaning money – not giving it away – so that these women, who have no business background, can become something, not just get something," Hensley said. "Economic control, even at this modest level, does amazing things to communities."

Reliable repayment has also been the key for SOFOLES.

Since loans are relatively small and overseen by the government, it is easy to coordinate repayment through salary deductions. Until now, because of high interest rates, home mortgages in Mexico have not been common; the rich simply paid cash for property, while low-income families often pooled money to buy and occupy one house via informal *tandas* – community savings cooperatives.

Government Steps In

But President Vicente Fox, starting in 2000, ramped up the SOFOLES. The Mexican leader's goal was rescuing a government home-building agency that was becoming a drain on public finances. The government made it easy for private

financiers to act as mortgage lenders by eliminating many of the customary requirements of a full-fledged bank.

As a result, in 2004, SOFOLES lent \$1.4 billion for small home mortgages – mostly less than \$50,000 – almost equal to the \$1.7 billion in home lending by traditional banks in Mexico. Special interest lending now accounts for 90 percent of the home-mortgage market among low-income families in Mexico, according to industry figures.

Nevertheless, the SOFOLES and microlenders – both traditional for-profit companies and some not-for-profit enterprises – are criticized in some quarters as a relatively high priced source for goods and services, which sometimes contains startlingly high interest charges.

"In Mexico, some commodity prices are high because, more than anything, there is no competition," notes Eduardo Garcia, editor of the business newsletter *Sentido Común* – Common Sense. "If these companies really wanted to make their goods and services accessible to a larger number of Mexicans, they would stop using their pricing power and the legal system to hinder those who want to enter the market. But to be honest, that's not the role of a private company, whose goal is to maximize profits."

Critics of the new wave of private businesses catering to the poor often point to the upstart Banco Azteca because of the interest rates (20-50 percent, depending on the term) the bank charges on small loans, and the interest rates its sister company, Elektra, charges for credit on consumer electronics products. For instance, the company charges 45 percent interest on a \$1,200 refrigerator paid for over 52 weeks.

The company maintains that it costs more to service tiny loans, and that because it serves a low-income (and thus a

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Sanchez's granddaughter enters a room in her new home.

higher-risk) market, its higher-than-market interest rates are justified. This claim may become difficult for Azteca to sustain, however, given growing empirical evidence that the poor actually pose a lower default risk than the average consumer loan clients in Mexico. (The default rate among standard Mexican consumer loan clients is about 2.9 percent, or more than two and a half times that for microloan clients.)

But Elektra is Mexico's largest consumer appliance retailer precisely because its financing plans – 'pay a little each week, for many weeks' – keep products within reach of many low-income families who cannot afford big lump sums or high monthly bills. Banco Azteca is also Mexico's fastest-growing bank, of late, because it is aiming its financial services at a portion of the population that is craving financial services.

Banco Azteca's approach is like the microlending schemes in that its consumer loans are about \$900 – well below the minimums of traditional banks. In the coming months, the company, owned by Mexican television tycoon Ricardo Salinas Pliego, will roll out microloans aimed at the self-employed and the tiny family businesses that dominate the lower half of Mexico's economy. Azteca, along with other Mexican retailers and lenders, is also seeking government permission to establish, and fund, a new credit bureau – Circulo de Credito – for middle- and lower-income bank customers.

The success so far of SOFOLES and private banks like Azteca are evidence of the substantial demand for credit among those traditionally marginalized by bankers.

This demand is being recognized in a new financial environment in Mexico. Were it not for recent reforms of bank-

ing laws – allowing foreign money to buy and support Mexican banks and increasing lending competition – endeavors that extend credit to the lower rungs of the economy might not have had the capital to get off the ground. Mexican banks have fully recovered from the so-called "Tequila Crisis" of a decade ago, when a massive peso devaluation cut the currency's buying power in half, cast at least a million people out of work, and drove consumer interest rates up to near 100 percent. That rate, in 1999, finally fell back below 20 percent, and bankers have been booking double-digit growth in lending ever since.

Profits in Waiting

Taken together, the lower segments of the income pyramid in some developing nations may hold impressive profit potential for innovative financial institutions, so long as they bend their lending policies toward communities and not try to force the new consumers to rise up to meet established corporate demands.

"There is a population that doesn't know the clean, quiet lobbies of traditional banks, yet has a tremendous pent-up demand for financial services, and for making money productive," said Margarita S. Quihuis, a fellow in the Digital Vision Program of the Reuters Foundation at Stanford University.

Quihuis, whose parents are Mexican and Native American, was a founder, in 1999, of the Women's Technology Cluster in San Francisco. A Stanford engineering graduate, Quihuis has merged her venture capital background with new money-transfer technology to create Indigo Financiera, a startup that next fall will sell special-use debit cards to Mexican migrants looking to send money home. The debit cards allow migrants to designate – with a phone call – funds from debit cards to recipient ATM accounts in Mexico. A portion of the profits from the cards will be used to form capital pools, which in turn will seed small-business ventures in the migrants' hometowns.

In 2005, remittances to Mexico are expected to reach \$20 billion, according to the Bank of Mexico.

"Access to capital in developing countries is a vexing problem," said Quihuis, who is developing the enterprise as part of her Stanford fellowship work. "We asked ourselves in thinking about Indigo: In what way can we take the best aspects of risk capital and shrink them down to the level that is reachable by migrants? This community of people, if it were to pool just a portion of its money, could leverage the capital against small- and medium-sized businesses and start pulling whole regions of Mexico out of chronic poverty." □