CGAP

BRIEF

# A Structured Approach to Understanding the Financial Service Needs of the Poor in Mexico

Financial service providers have traditionally focused more on the supply side of financial inclusion than on the demand side. Undoubtedly, it is easier to measure number of branches, total customers served, and aggregated portfolios rather than attempt to get into the messy business of poor and underserved customers' lives, businesses, and needs. However, we are starting to recognize the fundamental importance of working directly with customers to understand their financial habits and needs, as well as the role of finance in their lives. This brings a new perspective on the problem of financial inclusion: a deeper understanding of demand could be key to designing a more meaningful and sustainable offering, particularly as we realize how little we actually know.

Mexico is a middle-income country on the cusp of a significant transformation in the ways low-income and unbanked customers access and use formal financial services. Regulations now permit third-party correspondents to process transactions on behalf of banks, and a number of financial institutions and potential correspondent partners are looking for new formulas that marry the right products and channels to the needs of customers.

However, reaching the poor with formal financial products has proven to be a challenge. The mass-market segment comprises 22 million mid- to low-income households,[1] or roughly 85 percent of the population. Although 52 percent of such households have an active account with a financial institution, 90 percent of them choose not to use it for savings. Financial institutions are increasingly interested in serving the base of the pyramid, but few have a textured understanding of how low-income people use money and financial products now, and what sorts of products they may need or may want in the future. To close this knowledge gap, CGAP commissioned a study to explore the financial habits, needs, and wants of low-income customers in Mexico.

This study provides a detailed description of people's challenges in managing their cashflows, how they confront shortfalls, what choices they make in saving and borrowing money, and more generally, what strategies they use in their day-to-day financial lives. It combines quantitative analysis with detailed qualitative research, the combination of which helps paint a deeper picture of people's preferences and behaviors—how they think and how they make choices. People are then grouped into segments with common observed behavior.

## Segmenting the Mass Market

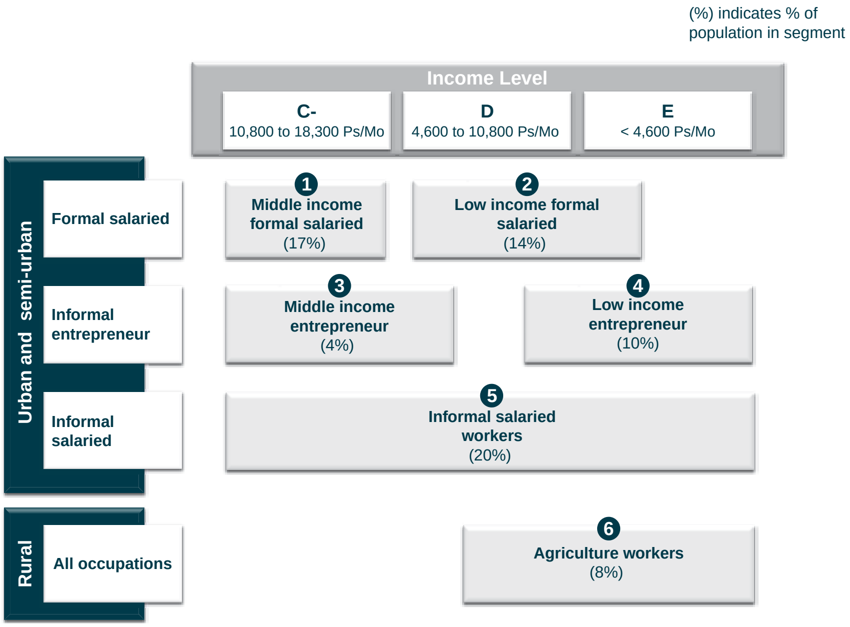
Data can be cut in many different ways. Finding out which dimensions might better explain certain behaviors can be challenging. Segmentation is an inductive process where one starts out with some set of hypotheses and subsequently use data to prove, disprove, or refine them. Our starting hypothesis was that livelihoods are the key driver for people's financial practices. Early in the study, with more granular data, we expanded this with additional hypotheses.

- Livelihood—determines the amount, certainty, and regularity of income
- Locality—the geographical location of people (urban, semiurban, or rural) determines the kinds of options available to them, e.g., formal or informal finance
- Level of income—determines the kind of "space" or bandwidth people have to make financial choices
- Lifecycle stage—where people are in their lives, e.g., obtaining an education, starting a family, starting a livelihood, affects the priorities, needs, aspirations, and concerns that influence how people make choices

May 2012

1 As measured by the national household survey on income and expenses ("Encuesta Nacional de Ingreso y Gasto de los Hogares, ENIGH").

**Figure 1: Segment Definitions**




To explore the relationship among these variables and people's financial behavior, we conducted a nationally representative survey with 426 households in income segments "C-" and below (income less than US$1,440/month, and at least one person economically active in the household).[2] This survey collected data around four areas: (1) income structure (income and expense cashflows), (2) aspirations, (3) concerns, and (4) money management strategies. Each interaction was designed as a 90-minute interview to ensure a proper relationship was established and people were open to talking about their finances. This also helped capture information on the sidelines that was later useful to orient our hypotheses.

Data from the survey indicated that most people had very similar concerns and aspirations:

- Most people are concerned about meeting education expenses for their children, and meeting medical expenses if someone in the family gets ill.
- Most people also aspire to have better housing. Investing in a business, getting a better job, and achieving financial stability were also frequently mentioned across all segments. At the extreme lower income segments, people want to ensure they are able to meet basic needs (food, clothing, and shelter).

Although lifecycle stage seemed to be a strong factor, we felt deeper research was needed to adequately analyze this dimension. We therefore focused on the other three variables (income structure, setting, and level of income) for which we had significant data to correlate with financial behavior. Figure 1 illustrates our chosen segment definitions.

Following the national survey, we conducted 32 in-depth interviews with people across all segments and three additional focus groups to validate and refine our hypotheses.

Table 1 shows a characterization of segments in terms of type of livelihood, behavior patterns, financial management strategies, and resulting financial needs (only lower income segments are shown). The results help us to understand the kind of products that each group of people would find more useful than others.[3] We can observe a strong connection between people's money management strategies and the "income structure" (the amount, variability, and regularity of the income). The frequency and the size of mismatches between income and expenses create a need for flexibility to move money in time. Consequently, people use savings and credit in different ways to deal with foreseeable expenses, unplanned events, and shortfalls. Therefore, people will perceive these

2 This comprises 22 million households with incomes below 18,300 pesos per month (US$1,450). This excludes 3.04 million households where the head is noneconomically active.

3 The full report is available at http://www.cgap.org/gm/document-1.9.55527/Mexico_BoP_Segmentation.pdf

### Table 1: Characterization of Lower Income Segments

| Type of Livelihood | Formal Salaried | Informal Salaried[1] | Entrepreneurs | Seasonal / Agriculture |
|---|---|---|---|---|
| **Average household income[2]** | **US$12/day** | **US$15/day** | **US$10/day** | **US$4–10/day[3]** |
| **Income structure** | **Fixed income at fixed periods of time—fortnight or weekly** | **Variable amount at fixed periods of time—weekly** Income perceived consistently but amount paid varies depending of hours worked or sales. | **Variable amount—daily** Income depends mostly on daily transactions, which vary day-to-day. | **Variable amount at irregular periods of time** Income from farming (agriculture and animal farming) is low and uncertain. |
| **Example of livelihood** | • Store clerk<br>• Plant employee<br>• Janitor | • Cook at informal food stand<br>• Wage worker<br>• Construction worker | • Taxi driver<br>• Merchant<br>• Street vendor | • Smallholder farmer<br>• Dairy products<br>• Animal farming |
| **Attitude/ behavior** | Prefer certainty; actively set and manage goals; focused in planning ahead; weary of credit. Natural savers. | Accustomed to uncertainty. Constant worry of meeting basic needs. Less rational choices. | Business minded; seek opportunities to make money; risk taker; multiple financial relationships open at a time | Low-skilled, limited abilities to build financial assets; focused on getting by. |
| **Financial management strategy** | **Saving and Planning to Fulfill Aspirations** Routinely save for planned expenses and to achieve goals. They have a relatively higher degree of education and have longer planning cycles. They use credit mostly for unexpected expenses (e.g., emergencies). Saving is their key money-management strategy. | **Managing Cash to Meet Expenses** Focus on planning cashflows to meet expenses. They use short-term savings for planned expenses but often borrow to make ends meet. Seem to be a transitional occupation, as people tend to eventually adopt other more stable livelihoods. Often other members of household adopt salaried work that provides a steady source of income. | **Actively Managing Financial Assets** Jointly manage household and business finances. They rely on a mix of savings and credit to confront shortfalls. They save to meet planned expenses, but routinely opt for credit to meet unplanned needs and to capture business opportunities. They often "save" by investing in their business (limiting liquidity). They often keep multiple concurrent relationships (several open loans, savings) to ease maneuvering. | **Managing Costs with Limited Options** Households have very limited options (family and friends are also poor). Stretch themselves and family to reduce consumption habits (including food) to make expenses meet available resources. Most households supplement income through other sources. Non-ag income brings additional US$10–15/day in large households. |
| **Saving profile** Savings as multiple of monthly income | 4.1 | 3.1 | 3.4 | 0.5 |
| **Credit profile** Credit as multiple of monthly income | 0.7 | 0.7 | 1.3 | 0.4 |
| **Financial services that would be most valuable** | Broad portfolio of savings options (varying terms, interest rates); commitment savings; long-term savings | Simple savings plans, ideally with small/ short-term credit options | Short-term credit for liquidity management; convenient transactional instruments; simple savings plans | Saving with credit for emergencies; insurance plans; microsaving; financial planning tools |

[1]Informal salaried workers includes people with middle incomes.
[2]Total reported income in household per month divided by 30. Most households reported average spending of ~US$10/day on food.
[3]None of the households interviewed in this segment had a purely seasonal income. All of them had alternate informal activities (wage workers, entrepreneurial) to complement income. The average household income (full with non-ag) was an average of US$19/day.

products differently, depending on how they help address specific money management challenges.

Although savings and credit are common across all groups of people, the ability to save and adequately serve debt is constrained by efficient liquidity management. Ideally, financial products should help people cope with financial challenges both for liquidity management as well as for increasing their financial assets:

- **Formal salaried workers** with stable and predictable income ordinarily save to meet goals. They would value a portfolio of savings products that give them options to save with different kinds of return and liquidity options. They would also value easy access to credit to meet emergency needs.
- **Informal salaried (wage) workers** struggle to manage fluctuations in income to meet expenses. Regularity in income facilitates planning, but would value simple savings products that help them plan for foreseen expenses and commitment savings to achieve longer term goals. Savings history can serve as a basis to assess ability to serve debt. Short-term credit would be valuable to smooth out shortfalls.
- **Entrepreneurs** who earn a variable income, usually on a day-to-day basis, would value a portfolio of credit options that provide liquidity to respond to business opportunities, and smooth out expenses across business cycles. They would also benefit from transactional and payments products that they can use to put away money temporarily as a means to manage cashflows and save.
- **Seasonal/agriculture** workers have the most irregular income, usually insufficient in itself. These households usually adopt other livelihoods to supplement income and group in extended families to pool income and expenses. They would value microsavings products, insurance, and small-value credit for emergencies. This group seems to be the most vulnerable, and would benefit most from broader financial planning and literacy.

The study also helped us understand the value of informal options used today. Saving at home is easy, low cost,[4] and convenient. Informal credit is easily accessible from family and friends, bears little or no interest, and has flexible terms of repayment. Friends and family constitute a financial network that strengthens the social fabric (family bonds, business ties). People save in groups as it unites them in solidarity for a common purpose (usually a friend needing extra money).

## Key Lessons

Every person is likely to use some form of credit and savings and is likely to find value in insurance and payments products. However, different segments face distinct challenges to manage their finances and will value more particular products:

- **Liquidity management and consumption smoothing emerge as the top needs of most households.** Poor households need short-term credit and savings to manage their liquidity as much as or even more so than for "asset building" (as in starting a new business or saving to increase assets).
- **Regular income is an important driver of savings patterns.** Even though everyone routinely saves, households with regular income are more likely to save for the mid- to long-term future.
- **Informal financial and social networks are an important source of finance for low-income people.** Formal providers need to understand their added value compared with informal options.

By turning away from a "mass" approach to addressing individual segments' needs, institutions can be more effective at tailoring products that link more directly to people's lives, and ultimately increase the likelihood of designing commercially sustainable products. The traditional vision of "lowering the transaction cost" as the means to achieve that does not go far enough—institutions need to design meaningful products, understand how they create value for customers, and adopt more adequate forms of pricing.

We're hopeful that segmenting the market along the lines of this study can become a more common element of business model and product design, and ultimately improve the range and quality of financial services available to the mass market in Mexico.

4 Customers perceive this as low or no cost, though as we all know, saving in cash risks theft and loss and sacrifices possible interest or returns, thus representing a less obvious form of "cost."

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May 2012

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