

EVALUATING THE SUCCESS OF MICROFINANCE IN MEXICO

An Undergraduate Research Scholars Thesis

by

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Submitted to the LAUNCH: Undergraduate Research office at
Texas A&M University
in partial fulfillment of requirements for the designation as an

UNDERGRADUATE RESEARCH SCHOLAR

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May 2023

Major:

International Studies - Commerce

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ABSTRACT

Evaluating the Success of Microfinance in Mexico

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Microfinance aims to combat poverty and enhance financial markets globally by serving individuals and communities in developing countries. To determine the impact of microfinance, it's essential to understand a country's macroeconomic conditions. Mexico has a thriving microfinance market, making it a valuable case study for understanding similar emerging economies. The commercialization of microfinance institutions is a topic of contention among experts. This thesis will examine how Mexico's macroeconomic context affects the effectiveness of microfinance as a poverty alleviation tool, and assess the commercialization debate by examining socially oriented and commercialized Mexican microfinance institutions and their advantages and limitations. Additionally, an interview with Alvaro Chocano, the Director of Investor Relations at MICROWD microfinance firm, provides valuable insight into the current state and future outlook of the industry and his opinions on microfinance commercialization.

DEDICATION

To my friends, families, instructors, and peers who supported me throughout the research process.

ACKNOWLEDGEMENTS

Contributors

I would like to thank my faculty advisors, Dr. Adel Varghese and Dr. Maddalena Cerrato for their guidance and support throughout the course of this research.

Thanks also go to my friends and colleagues and the department faculty and staff for making my time at Texas A&M University a great experience.

Finally, thanks to my peers for their encouragement and to my family for their patience and love.

Funding Sources

Undergraduate research was supported by Texas A&M University.

This work received no additional funding.

1. INTRODUCTION

Poor communities experience a cycle of poverty, often ignored and stuck in difficult situations determined by their surroundings. Nevertheless, there is a worldwide effort to alter their future prospects. Innovation and creative thinking have sparked new opportunities, with microfinance being one such solution. Muhammad Yunus, a former economics professor, started the Grameen Bank, the world's first microfinance institution, after lending a few cents to a female entrepreneur in a rural Bangladesh village and observing her prompt repayment. Microfinance offers a path to wealth creation by providing access to financial services to motivated individuals who lack traditional banking options.

The lack of banking institutions in developing countries impedes growth and hinders the mobility of money, essential for investments and capital gains (Apfel, J., 2015). This leads to a concentration of wealth in the hands of a few, as resources are not efficiently allocated, resulting in reduced growth, productivity, and income for middle and low-income populations. Microfinance provides a solution for marginalized individuals, serving as an alternative to the formal banking sector. Through microfinance, clients increase their savings and investments in areas such as health, property, and education, leading to a more optimistic outlook on their future. Many microfinance borrowers are entrepreneurs, whose business expansion brings positive economic impacts to their communities by boosting production and creating new job opportunities.

The significance of microfinance research is valuable for various stakeholders, including investors, microfinance institutions, international organizations and policymakers. Investors utilize microfinance research to determine where to invest their dollars for a higher return on

investment. By analyzing macroeconomic conditions, the success of microfinance loans can be predicted. Microfinance institutions benefit from this information by being able to better evaluate the communities in which they can effectively operate. For instance, they consider factors such as high GDP, which increases the likelihood of borrowers repaying their loans. Governments and international organizations can also benefit from this information by creating macroeconomic policies that promote success across all sectors of the economy, both formal and informal. This, in turn, leads to an improved standard of living and a stimulated domestic market.

The success of microfinance, however, depends on the macroeconomic context. Indicators such as GDP growth, labor force participation, sectoral shares of GDP, and private credit ownership vary among international economies, influenced by their existing political and economic institutions. Therefore, a proper evaluation of the macroeconomic context should dictate whether or not microfinance is an appropriate tool for financial alleviation in a particular community.

Imai et al. (2012) highlights the practical difficulties in conducting empirical studies on microfinance. These difficulties include obtaining reliable data, quantifying social variables, distinguishing between the size and reach of social impact, and the varying robustness of estimates applied to different national contexts (Imai, K., et al, 2012). For instance, the percent of the population working in the informal sector presents a challenging variable, as financial metrics in this sector are not accurately recorded due to imperfect information. These issues raise concerns about the validity of microfinance research, but also provide an opportunity for further exploration and debate on the relationship between macroeconomics and microfinance.

This study explores the interplay between microfinance and Mexico's macroeconomic environment through a personal interview with Alvaro Chocano, director of investor relations at

microfinance institution – MICROWD, and personal research. Mexico, as of 2018, has the highest number of microfinance borrowers in Latin America and the Caribbean and ranks fourth globally (Center for Financial Inclusion, 2019). This thesis posits that the limitations in creating a socially impactful microfinance market in Mexico are due to its macroeconomic context and its drift towards a commercialized approach. The study aims to comprehend the intricate relationships between Mexico’s economy and its microfinance institutions, as well as uncover the ethical and financial concerns surrounding them.

2. REASONING FOR EXPLORATION

I dedicated my senior thesis to “Evaluating the Success of Microfinance in Mexico” because of a deep passion for development economics and previous microfinance work experience. In summer 2022, I was an intern for MICROWD, a profit turning, socially-oriented microfinance institution based out of Madrid, Spain, that serves female entrepreneurs across Latin America. Through frequent discussions with my manager, who was a career-long investment banker, I gained valuable insight into the challenges facing the industry, such as volatile exchange rates, and the struggles and successes of determined clients. My manager had turned to MICROWD from a career making lots of money because he wanted to have a positive social impact, and he oversees hundreds of investor portfolios while continually updating reports on their returns and social impact.

I chose to focus on Mexico as a case study because not only does MICROWD serve many Mexican communities, but I also feel a personal connection to the country. As a Texan, I am familiar with the vibrant culture shared between the two nations in terms of food, fashion, art, language, business, and politics. Getting to know communities leads to better development. In addition to this, a friend of mine from a rural village in Guanajuato, Mexico, explained that his village lies on top of a major transportation line with millions of cars and trucks passing through each year. If the town was developed, passing traffic could be a major source of income for small businesses, and microcredit could potentially help his town’s case for obtaining more government funding for infrastructure projects.

3. LITERATURE REVIEW

3.1 Introduction

This thesis is structured into three sections, each focusing on a different aspect of microfinance in Mexico. The first section provides an overview of Mexico's climate for microfinance and how its macroeconomic condition affects it. It explores the history of microfinance in Mexico, detailing legislative efforts made to support its development and growth, and its global status. It also contents how its current macroeconomic challenges, including the impact of COVID-19, the Ukrainian War, global supply chain slowdowns, workforce participation, financial inclusion, and the informal economy, have created a need for progress of the microfinance industry. This section provides valuable context for understanding how microfinance can address these economic concerns as well as emphasizing the importance of expanding the presence of microfinance in Mexico.

The second section delves into the commercialization debate and its impact on microfinance in Mexico. It presents the arguments for and against the commercialization of microfinance, and provides a nuanced examination of the potential effects that this debate could have on the future of microfinance in Mexico.

The final section concludes the thesis by summarizing the key findings and providing recommendations for future research and policy. In all, this thesis offers a comprehensive overview of the key issues surrounding microfinance in Mexico, providing valuable insights for policymakers, microfinance institutions, and researchers interested in understanding the role that microfinance can play in supporting the economic development of the country.

3.2 Macroeconomic & Microfinance Literature

This portion of the literature review provides valuable insights into the challenges faced by individuals in accessing financial services in Mexico and the role that microfinance can play in addressing these issues.

According to a 2022 report by OECD, several factors prevent individuals in emerging economies like Mexico from accessing financial services. To address this challenge, Mexico should consider adopting unconventional methods to increase financial inclusion and meet the needs of its underprivileged population. The report found that the primary reasons for limited financial access in Mexico are unaffordability, failure to meet client or credit requirements, preference for other forms of savings, lack of trust and knowledge about financial services, preference for other forms of savings, high interest rates, and geographical barriers to access. Microfinance has the potential to address most of these deterrents and increase access to financial products, thereby increasing financial depth in Mexico. The OECD report provides valuable insights into the challenges faced by individuals in accessing financial services in Mexico and the role that microfinance can play in addressing these issues. By promoting the use of microfinance, Mexico has the opportunity to increase financial inclusion, boost economic growth, and reduce poverty and income inequality.

The Mexico Economic Outlook for 2022 by Zaga and Ortiz provides a comprehensive analysis of Mexico's macroeconomic situation and the impact of global crises on its economy. The report highlights the exacerbation of existing economic challenges, such as inflation, unemployment, and poverty, due to global supply chain slowdowns, the Ukrainian War, and COVID-19. This information is relevant to the research as it highlights the need for solutions to address these economic difficulties. The authors of the report also speculate about the potential

reconfiguration of the global trade order and the possibility of the world market splitting into regional production hubs in North America, Europe, and Southeast Asia. This potential split could have adverse effects on Mexican microfinance as many of its donors and investors are based in European and Asian countries. My thesis offers the argument that microfinance can play a crucial role in mitigating poverty and unemployment caused by these macroeconomic challenges in Mexico.

Jessica Belmont's article sheds light on the efforts made by Mexico's legislative bodies to promote sustainable financial practices, such as microfinance. The author highlights several pieces of legislation that have been implemented, including the Mexico Strengthening Economic Sustainability DPR, the COVID-19 Financial Access DPF, and the Expanding Rural Finance Project. These initiatives have already made a positive impact on over 100,000 individuals in Mexico. This report is relevant to my argument as it showcases the government's commitment to expanding socially impactful financial institutions in the country. However, Belmont fails to acknowledge that despite these legislative efforts, most microfinance institutions cannot operate in an expansive fashion due to a reliance on minimal government and donor funding.

In 2015, Josh Apfel's thesis (2015), evaluated microfinance's performance through a panel of developing nations. Apfel's thesis utilizes growth theory and the neoclassical growth model (popular growth models in economic development) to understand whether or not microfinance is a key determinant of growth. His results are split between whether the incorporation of microfinance is just a trend for countries experiencing increased growth or if it is a driver of growth (Apfel J., 2015). But, Apfel does not account for the split between commercialized and socially-oriented models of microfinance, which may carry unforeseen biases in his results.

The Center for Financial Inclusion's 2019 report displays global and regional microfinance metrics. The data from this report comes from Mix Market, a branch of the Center for Policy Development within the World Bank. It was from this report that the focus on Mexico for the purposes of the thesis was decided, due to its global position in microfinance. Mexico stands out as a regional and global leader in microfinance due to its large number of clients, investors, and microfinance institutions (Center for Financial Inclusion, 2019). Mexico also has the lowest average loan balance per borrower out of any other Latin American country (Center for Financial Inclusion, 2019). These metrics indicate that microfinance institutions can successfully operate within Mexico's macroeconomic context. Despite this argument, hinderances to success include volatility in exchange rates and rising inflation, which have hindered growth in the number of borrowers and gross loan portfolios (Center for Financial Inclusion, 2019).

Triple Jump is a significant microfinance institution that operates in Latin America, Asia, Africa and Europe, supporting 2.7 million microfinance borrowers and holding 907 million euros of assets under management (Triple Jump, 2017). In 2017, they released a publication that details Mexico's market for microfinance, providing a comprehensive explanation of its history, legislative efforts, and market demand. The report also engages in the debate over the different interest rates between commercialized (for-profit) and socially oriented microfinance institutions. This article is relevant to my thesis as it is the only piece of literature that synthesizes the commercialization debate with the broader market for microfinance in Mexico.

Overall, this section of literature highlights the challenges faced by individuals in accessing financial services in emerging economies such as Mexico, which include unaffordability, high interest rates, geographical barriers to access, and lack of trust and

knowledge about financial services. Microfinance has the potential to address most of these challenges and increase financial inclusion in Mexico. Despite legislative efforts to promote sustainable financial practices, most microfinance institutions cannot operate in an expansive fashion due to a reliance on minimal government and donor funding. Mexico stands out as a regional and global leader in microfinance, but hinderances to success include volatility in exchange rates and rising inflation, which have hindered growth in the number of borrowers and gross loan portfolios. By promoting the use of microfinance, Mexico has the opportunity to increase financial inclusion, boost economic growth, and reduce poverty and income inequality.

3.3 Commercialization Debate Literature

The commercialization of microfinance institutions has been a topic of debate in recent years. Scholars and practitioners have differing opinions on the advantages and disadvantages of commercialized versus socially oriented microfinance institutions. This debate is especially relevant as the drop in donor funding threatens the continuation and expansion of socially oriented microfinance institutions, forcing them to turn to alternative forms of funding. The articles discussed in this section provide different perspectives on this complex issue, highlighting the need to find a balance between ethical concerns and financial sustainability in microfinance.

Ian Carrillo's (2009) study provides an original framework for determining the types of microfinance institutions that work best in Mexico. His survey of eight borrowers from Oaxaca revealed that the success of loans depended on the borrowers' reasons for applying. Borrowers who received loans from commercialized microfinance institutions found them to be unhelpful, as the institutions' operational practices carried severe penalties if a client could not pay back their loan (Carrillo, I.R., 2009). In some cases, borrowers sold their homes or all their

possessions to avoid criminal debt (Carrillo, I.R., 2009). Carrillo's report uncovers personal justifications regarding the advantages and disadvantages of commercialized and socially oriented microfinance institutions. Carrillo, however, does not predict what implications the advantages and disadvantages of both commercialized and socially-oriented models have on the future of microfinance.

Md Aslam Mia (2022) debates scholarly definitions of commercialization in microfinance and reasons why the commercialization trend is spreading across many microfinance institutions. Mia argues that the drop in donor funding threatens the continuation and expansion of socially oriented microfinance institutions, forcing them to turn to alternative forms of funding. "For example, on average, an MFI (based on a global sample) received US \$120,000 in 2000, which later contracted to one-fourth (US \$30,000) in 2018" (Mia, A., 2022). Therefore, alternative forms of funding may be necessary for the survival of a microfinance institution. However, Mia does not address the sometimes unethical manor of commercialized institutions, which are addressed throughout this thesis.

Jonathan Lewis, the founder of Mexican microfinance institution MicroCredit Enterprises, has outwardly spoken against the unregulated commercialization of microfinance institutions. In his socially-oriented advocacy report "Microloan Sharks" (2008), Lewis argues that microfinance institutions must re-focus their attention on the social impact of their loans. He calls out Banco Compartamos as the "poster-child" of an ethically dubious commercialized institution due to its outrageous interest rates and excessive profitability (Lewis, 2008). Lewis suggests that investors and donors should set a global standard for how microfinance institutions should operate by leaving commercialized firms. He argues that unethical practices are not sustainable, and eventually, regulatory bodies will have no choice but to intervene in

microfinance affairs given its rapid growth. He also draws comparisons between American industry practices and commercialized microfinance institutions by questioning their transparency and interests.

The articles above highlight the ongoing debate around the commercialization of microfinance institutions and its implications for borrowers and the future of microfinance. Carrillo's study reveals that borrowers who received loans from commercialized microfinance institutions found them to be unhelpful and sometimes unethical, while socially oriented microfinance institutions were preferred. Mia argues that the trend towards commercialization is spreading due to the drop in donor funding, forcing microfinance institutions to turn to alternative forms of funding to survive. Lewis advocates for a return to socially-oriented microfinance and suggests that investors and donors should set a global standard for how microfinance institutions should operate. These articles show that the commercialization debate in microfinance is complex, with ethical concerns and financial sustainability at odds. The future of microfinance may depend on finding a balance between these two priorities.

4. METHODOLOGY

My thesis is a journalistic analysis that focuses on the presence, meaning, and relationships of microfinance in a macroeconomic context. This method allows me to understand microfinance's role within Mexico's broader economy. I studied which of Mexico's current economic challenges are at least partially solvable through the utilization of microfinance and examined the commercialization debate, which has its roots in Mexico, to figure out if Mexican microfinance institutions are limiting their potential by becoming commercialized. I also obtained a personal interview with Alvaro Chocano, an employee of MICROWD microfinance, who provided valuable insights into the current status of the industry. Together, these studies present an argument that is difficult for Mexico to establish a successful, socially-impactful market for microfinance due to its macroeconomic challenges and the movement toward profit prioritizing institutions.

5. CURRENT CHALLENGES AND CONDITIONS OF THE MARKET FOR MICROFINANCE IN MEXICO

5.1 Financial Inclusion in Mexico

Microfinance emerged in Mexico in the early 1990s as a result of investors learning from Muhammad Yunus that microcredit can be used to alleviate poverty and promote growth at the base of the pyramid. Most individuals at the base of the pyramid exist within the informal economy, where microfinance borrowers conduct their business operations. Mexico's informal economy is significant, with 22.6 million Mexican people reporting employment in informal jobs (Rocha, H.J., 2021). This market represents an opportunity for microfinance to flourish and contribute to Mexico's economy.

Financial inclusion is another significant macroeconomic variable that demonstrates Mexico's need for sustainable microfinance institutions. Less than 70 percent of adults in Mexico use at least one financial product, such as a bank account, credit, insurance, or retirement savings (OECD, 2022). Access to financial services depends on factors such as educational attainment, income, and accessibility, with affordability and travel time to financial access points being the root determinants of access to financial services. Each of these barriers to financial access can be alleviated by growing the market for microfinance institutions to flourish.

There is great disparity between account ownership in the formal and informal sectors, with only 57.4 percent of informal employees holding one of these accounts, whereas 95.7 percent of formal employees have access to at least one type of financial service (OECD, 2022). Microfinance has been proven to increase household savings in health, home, and education and

increase incomes, making it an excellent incentive for Mexican legislators and microfinance investors to push for serving the informal sector to achieve the highest level of financial inclusion.

5.2 Gender and Sectorial Financial Inequities in Mexico

Financial inequities are also felt between sectors and genders, with the private non-financial sector in Mexico being just 42 percent of GDP, well below the 143 percent average for emerging markets worldwide (Belmont, J., 2021). There is also an 8 percent gender gap in access to accounts and digital payment services, highlighting the need for alternative financial services such as microfinance that promote gender equity and shrinking inequality (Belmont, J., 2021).

A survey conducted by economists from Banco de México examines gender disparities in microfinance and group loans by analyzing macroeconomic and microfinance data before and during the COVID-19 pandemic. The study finds that female borrowers of group loans default earlier than male borrowers, while female individual borrowers' default at a similar time compared to male borrowers (Bátiz-Zuk, E. & González Holden, A., 2022). The COVID-19 pandemic worsened repayment rates for both genders and loan types. The study recommends that regulators and banking industry risk managers should include an interaction in regulatory or internal loan loss models and financial authorities should introduce additional measures in banks' regulatory layouts to avoid potential crisis in the microfinance banking sector (Bátiz-Zuk, E. & González Holden, A., 2022). Additionally, field studies should investigate other determinates that could affect female time to repay loans such as health, education, and family.

5.3 Efforts to Promote Sustainable Finance and Government Legislation in Mexico

As of September 2020, Brazil, Chile, Colombia, and Mexico have emerged as leaders in successful sustainable finance markets in Latin America, which can be attributed to various

efforts, including expanding financial services, promoting sustainable practices, and facilitating dialogue between foreign and domestic investors (OECD et al, 2021).

Mexico's stature as a top lender for microcredit has drawn global attention and created a research void for academics to figure out how microfinance institutions benefit from this type of government legislation. In my interview with Mr. Chocano, he described the role of legislative bodies as having, "...the task of regulating and legislating the banking system, which includes credit and microfinance institutions. They establish the rules of the game, maximum interest rates, or loan conditions through the law" (A. Chocano, personal communication, March 14, 2023). From this analysis, I can infer that it might be difficult to navigate through these rules and regulations as a microfinance institution. However, Chocano points out that, "the sector is highly collaborative, and international partnerships between associations, foundations, NGOs, and financial institutions establish a necessary ecosystem of relationships to grow and develop this sector in an increasingly globalized world" (A. Chocano, personal communication, March 14, 2023). Therefore, beating out the issue of misaligned interests between the government and the microfinance industry, by working together to maneuver through everchanging legislation.

In spite of this, some legislative efforts have shown positive results, with Mexico having the highest number of microfinance borrowers in Latin America as of 2018 and ranking fourth globally (Center for Financial Inclusion, 2019). One such effort has been the Rural Microfinance Technical Assistance Project, which focuses on savings, investments, credit, insurance, and remittances and operates through alliances between specialized consultants and Mexico's largest microfinance institutions, Socaps and Sofipos, to expand access to financial inclusion in rural areas (Triple Jump, 2017).

In the earliest years of Mexican microfinance, the first institutions were established through NGOs with a primary focus on credit products. The Mexican government initially supported these institutions through technical assistance, financial funding, and resources to establish a robust and competitive market for microfinance institutions to flourish. In 2009, government funds were the main source of funds for 60 percent of microfinance institutions, while only 28 percent had commercial bank financing (Triple Jump, 2017).

In 2006, Banco Compartamos changes the notion that microfinance can only serve a social endeavor marked by ties to NGOs or government-sponsored missions. They became the first microfinance institution in the world to successfully obtain an IPO of its shares, increasing its funding through public offers on the stock exchange. This allowed them to turn a higher profit, similar to a common banking institution. This shifted the perspective within the field of microfinance, allowing microfinance institutions to focus on generating the highest level of profitability possible while generating a social impact. By the end of 2007, 74 percent of Mexican microfinance institutions operated for profit (Triple Jump, 2017).

Furthermore, this rapid commercialization, born without rules or standards, has resulted in disastrous consequences. Muhammad Yunus' idea for how microfinance institutions should operate play under a completely different set of conditions compared to a typical bank, as its original goal is to generate social equity and promote equality rather than turning a high profit.

Most of the Mexican microfinance institutions that followed Banco Compartamos' lead, "...took advantage of arbitration between different government programs to obtain funds from those with laxer selection criteria" (Triple Jump, 2017). Coupled with the previously noted external factors, the further lack of government planning resulted in over 60 percent of commercialized Mexican microfinance institutions failing to fulfill their promised investments.

This mistake, coupled with the 2008 financial crisis, reformed the legislative environment for microfinance in Mexico. This split between external and internal activities carries negative implications for Mexican microfinance, because as stated previously, most borrowers work in informal markets. The government has since become more cautious in matters relating to commercialization of microfinance institutions.

However, companies that successfully commercialized, like Banco Compartamos, experienced rapid growth, with the gross loan portfolio growing at a rate of 46 percent annually from 2006 to 2009 (Triple Jump, 2017).



Figure 1 - Triple Jump, 2017, The Evolution of the Gross Loan Portfolio and Non performing Loans 2006-2015. (Amounts in thousands of pesos).

The graph above demonstrates the evolution of the gross loan portfolio and non-performing loan from 2006 to 2015 in thousands of pesos, demonstrating the rapid growth in the gross loan portfolio after microfinance banks found success in Compartamos’ commercialized framework. Compartamos was the first microfinance institution to turn a high profit while promoting a social impact.

Mexico also experiences difficulties in growth due to weak intermediate enterprises and low participation from local companies, such as microfinance entrepreneurs (OECD et. Al, 2021). This difficulty further stems from dependent and uncontrollable global variables as

Mexico has faced a number of global challenges: the COVID-19 pandemic, Ukrainian War, and China's economic slowdown have had a significant impact on its economy.

In particular, the COVID-19 pandemic has increased poverty in Mexico by 9 percent and pushed extreme poverty an additional 8 percent (OECD et. Al, 2021). This has led to a depressed labor market, which in turn depresses real wages. In my interview with Mr. Chocano, he argues that, "...the COVID-19 pandemic, have had a tragic impact on the lives of our entrepreneurs. Not only due to health problems, both personal and family, but also due to lockdowns that prevent them from working and generating income. Health expenses in these developing countries are very high, which has further impoverished the population" (A. Chocano, personal communication, March 14, 2023). Thus, I believe Chocano would think COVID-19 and Mexico's macro environment would affect their business in a negative way since investors may be less willing to continue their investments, because productivity is more difficult to maintain during a pandemic.

Recovery from these numbers is difficult, especially for those working in the service sector, which historically recovers much slower than the manufacturing sector (Cañas, J., & Smith, C., 2021). This has created a split in productivity between Mexico's foreign and domestic markets, further exacerbating income inequality. Unfortunately, 40.3 percent of Mexico's population's incomes are below the minimum cost of a food basket, which is a poor indicator for recovery and growth (Zaga, D. & Ortiz, A., 2022). In addition, global challenges have created a global rise in inflation, which has damaged Mexico's purchasing power, causing a deterioration in real wages and an increase in overall prices (Cañas, J., & Smith, C., 2021). This is particularly concerning for microfinance, as less money will circulate in the informal economy, where most borrowers' businesses operate.

Investment in Mexico's informal economy alongside its foreign interests is necessary for recovery and growth. Recovery and growth will be difficult for Mexico unless it invests in its informal economy alongside its foreign interests.

5.4 Interview with Alvaro Chocano

In a recent interview, I had the opportunity to speak with Alvaro Chocano, who has worked in the financial sector since 1997. Over the course of his career, Chocano has managed various departments including Marketing and Communication, institutional relations, and clients. Currently, he serves as the director of Investor Relations for a Madrid-based microfinance institution called MICROWD. During our conversation, Chocano provided valuable insights into the current state of the microfinance industry and its future prospects. Listed below are my interview questions and Chocano's responses.

1. What are your beliefs about the controversy surrounding the commercialization of microfinance institutions?

“The microfinance sector is relatively young. It gained worldwide recognition thanks to the winner of the Nobel Peace Prize in 2006, Muhammad Yunus, who in the 1970s developed the foundations and concepts of microcredit and microfinance through his Grameen Bank. Microcredits solve an essential problem: they provide access to financing for people who are outside the financial system due to their limited sources of income. Yet, as is often the case, the negative derivatives of microfinance are heard louder and more frequently, such as over-indebtedness, fraud, usury, conflicts of political and business interests, or possible personal pressures in group loans. All of these problems can be controlled and minimized if the mission and objective are well defined,

that is, to help those who need it most and not those who want to take advantage of it.”

(A. Chocano, personal communication, March 14, 2023).

2. How does MICROWD expand its loan portfolio and client base?

“Before the launch of MICROWD, its founder Alejandro de León had an NGO (MAYAS: Maestros y Alumnos Solidarios) through which he provided scholarships and school supplies to children in need. While in Nicaragua visiting schools, Alejandro asked the mothers of the children what their needs were. They asked him for money to start and improve their businesses. In this way, in 2013, Alejandro began to lend to these mothers to improve their lives. Seeing that the women were paying back their loans, he asked for money from family and friends to reach a greater number of women, until he created MICROWD in 2015. Our company has always grown hand in hand with our borrowers, asking them how we can help them during the financing process.

Currently, MICROWD offers microcredits in 6 countries: Nicaragua, Peru, Mexico, Costa Rica, Uruguay, and Guatemala. We generally enter each country with a pilot project, alongside or in collaboration with a local partner (foundations, associations, NGOs) who work directly with the women we can lend to. If the process yields income and social impact, we establish our own regulated entity in the country (Microfinance institution, Credit Cooperative, Investment company, etc.).

As for investors, they are mainly Spanish, but we have clients from all over the world, with Latin America being particularly prominent. Our main way of attracting potential investors (leads) is through the internet and mass media (social networks, YouTube, investment podcasts, influencers, crowdlending websites, etc.)” (A. Chocano, personal communication, March 14, 2023).

3. What is the potential impact of the commercialized model of microfinance on the goal of poverty alleviation?

“The potential impact of microfinance on alleviating poverty lies in its capitalist system. Through the market economy (“buy for \$1 and sell for \$2”), levels of extreme poverty have been reduced to levels never before achieved by humanity. Capitalism has enabled people’s lives to improve as it seeks not to equalize, but to promote individual development and, therefore, the evolution and growth of society.

At MICROWD, our goal is to reduce poverty levels in the areas where we work, mainly rural areas. We measure the impact we generate through interviews with the entrepreneurs (once again, we improve our product by asking questions). This allows us to maintain our mission and vision and not deviate with other interests. The main metrics we analyze are: 1) number of jobs generated, income and savings evolution, 2) investment in education for their children, investment in the household, and investment in health, 3) diversification of their businesses, innovation in their community, and development of sustainable projects” (A. Chocano, personal communication, March 14, 2023).

4. How have global issues such as supply chain slowdowns, the Ukrainian War, and COVID-19 impacted the microfinance market and MICROWD?

“In general, investment in microcredits is uncorrelated with the market, allowing for diversification of a global investment portfolio. Crises can occur in developed economies, causing market downturns, but these events do not necessarily affect rural entrepreneurs, who continue with their lives within their community and are often unaware of the financial problems of the developed world.

For example, military conflicts like the war in Ukraine initially do not affect entrepreneurs, who continue with their lives within their community and are often unaware of the financial problems of the developed world.

Other global events, such as the COVID-19 pandemic, have had a tragic impact on the lives of our entrepreneurs. Not only due to health problems, both personal and family, but also due to the lockdowns that prevent them from working and generating income. Health expenses in these developing countries are very high, which has further impoverished the population.

However, we have seen how women adapt to circumstances, innovate in their businesses, or create new projects according to existing needs, with an extraordinary capacity to move forward” (A. Chocano, personal communication, March 14, 2023).

5. What role do governments and international organizations play in supporting or scrutinizing microfinance institutions? How has MICROWD been affected by policymakers?

“In the case of governments and the administration of each country, they have the task of regulating and legislating the banking system, which includes credit and microfinance institutions. They establish the rules of the game, maximum interest rates, or loan conditions through the law.

On the other hand, the sector is highly collaborative, and international partnerships between associations, foundations, NGOs, and financial institutions establish a necessary ecosystem of relationships to grow and develop this sector in an increasingly globalized world.

MICROWD has always acted in accordance with the law of each country, adapting to the regulations and demands of each administration. In some countries, we have seen greater difficulties for foreign entities than for national ones, but generally, we offer a product managed by local teams that improves the lives of the communities where we work.

However, we have seen how women adapt to circumstances, innovate in their businesses, or create new projects according to existing needs, with an extraordinary capacity to move forward” (A. Chocano, personal communication, March 14, 2023).

6. Why do you work in microfinance?

“I have worked in the world of finance and investment since 1997. I have always been on the side of the “wealthy” seeking the best options to grow their wealth. In 2018, I was fortunate enough to start working at MICROWD, where the goals are more human than economic. I believe that microfinance can help us live in a better world. Before, I tried to make the “wealthy” even richer. Now, I try to make the “poor” rich” (A. Chocano, personal communication, March 14, 2023).

In conclusion, Alvaro Chocano, the Director of Investor Relations for MICROWD, provided valuable insights into the microfinance industry and its future prospects. He discussed the controversy surrounding the commercialization of microfinance institutions and the negative impacts that can arise if the mission and objective are not well defined. Chocano also explained how MICROWD expands its loan portfolio and client base, mainly by working hand in hand with borrowers and collaborating with local partners.

Chocano believes that microfinance can have a significant impact on poverty alleviation, and capitalism is the way to achieve it. He stated that MICROWD’s goal is to reduce poverty

levels in rural areas where it works and measures its impact through several metrics, such as job creation, income, and savings evolution, investment in education, health, and innovation in the community.

Finally, Chocano discussed the impact of global issues on the microfinance market and MICROWD. He explained that crises in developed economies do not necessarily affect rural entrepreneurs, but events such as the COVID-19 pandemic have had a tragic impact on the lives of borrowers. Despite the challenges, Chocano noted that women's capacity to adapt to circumstances, innovate in their businesses, and create new projects. Overall, the interview provided valuable insights into the microfinance industry and the mission of MICROWD.

6. COMMERCIALIZATION DEBATE

One of the most contested issues in microfinance research centers around the commercialization of microfinance institutions. This issue has its roots in Mexico, as Banco Compartamos was the first commercialized microfinance institution. Leaders in microfinance, governments, and international organizations have mixed reviews of support and scrutiny regarding Compartamos. Some argue that commercialization is necessary to survive operational costs and expand outreach, while others argue that it diverges from the ultimate goal of alleviating poverty. This section of the thesis evaluates whether Mexico is better served by microfinance institutions based on social or profit returns.

Microfinance researchers define commercialized microfinance institutions to include a variety of factors. There are three scholarly definitions that encompass the nature of commercialized microfinance institutions. Charitonenko describes commercialization as the adoption by microfinance institutions of market-based principles in their microfinance activities, regardless of whether they are under prudential or non-prudential government regulations (Charitoneko, S., 2003). This definition includes the incorporation of market-based principles such as funding, financial return, cost recovery, efficiency, and governance, as well as a macroeconomic regulatory environment that supports commercialized institutions (Charitoneko, S., 2003). Therefore, this definition calls for a need to establish legal and regulatory microfinance entities, available commercialized funds from the financial sector and present supporting institutions such as a credit information bureau, credit rating agency, microfinance trade association and microfinance technical training institutions (Mia, A., 2022). In my

interview with Mr. Chocano, he said that, "...problems can be controlled and minimized if the mission and objective are well defined, by helping those who need it most and not those who want to take advantage of it" (A. Chocano, personal communication, March 14, 2023). That is, to provide access to financing to people who are outside of the financial system.

Hamada presents another definition that includes an ethical perspective, hinted at by Mr. Chocano. Hamada defines commercialized microfinance as the application of market-based principles and the transformation of a microfinance provider or project into a regulated financial institution (Hamada, M., 2010). This definition brings forth the concept of 'mission drift', where the shift from socially-oriented market practices to for-profit market practices represents a departure from the original goal of poverty alleviation.

Lastly, Hoque et al. defines commercialization of microfinance as changes in funding techniques of microfinance institutions. This refers to a movement away from government and donor subsidies to alternative forms of funding, such as public investments, since government and donor subsidies are limited and often insufficient to support microfinance institutional operation costs. "For example, on average, an MFI (based on global sample) received US \$120,000 in 2000, which later contracted to one-fourth (US \$30,000) in 2018)" (Mia, A., 2022). This definition brings attention to the often inescapable need to diversify funding in order to sustain operations.

Advantages	Disadvantages
Self-Sustaining	Temptation to focus on profits
High Mobility and Flexibility	Over-lending
Offer Diverse Products	Need for Strong Supervisory and Regulatory Bodies
High Financial Efficiency	
High Outreach	

Figure 2 - Carrillo, 2009, Commercialized MFIs: Advantages and Disadvantages

Advantages	Disadvantages
Commitment to Poverty Reduction	Low Outreach
Offer skill training, medical services, and education	High Losses
High Social Returns	Capital-constrained

Figure 3 - Carrillo, 2009, Non-profit MFIs: Advantages and Disadvantages

The advantages and disadvantages of commercialized and non-profit microfinance institutional approaches are summarized in two charts presented in this section. An efficient microfinance institution can deliver financial services to the informal sector that has often lacked access to financial products and services. While some argue that the commercialized approach is the best way to expand outreach to better serve poorer populations on a long-term basis, others claim that the for-profit model would isolate the poor (Mia, A., 2022). Based on the given definitions of the commercialization of microfinance, it is true that both commercialized and socially-oriented institutions need to earn a profit to be sustainable. However, the financial surplus in for-profit institutions is contested. Mexican microfinance institutions should seek a

balanced framework between the for-profit and socially-oriented models of microfinance institutions. By doing so, Mexico can achieve the greatest amount of impact while simultaneously expanding client outreach.

6.1 Pro-Commercialization Argument

The commercialized model of microfinance is said to solve inefficiencies faced by socially-oriented microfinance institutions that struggle to survive. These institutions may look to corporate investors as a primary source of funding instead of relying on donations from NGOs or subsidies from the government. Banco Compartamos, one of the original Mexican microfinance institutions, was the first microfinance institution to receive an IPO in 2008 (Carrillo, I.R., 2009). Their shift from a government-sponsored organization to a commercialized institution created rapid yearly growth in loan portfolio and number of clients. The growth of Banco Compartamos from 2002 to 2008 can be summarized in the chart provided in Figure 5.

Year	Active Portfolio	Amount Dispersed	Active Clients
2002	\$43,030,870	\$179,124,272	144,991
2003	\$64,213,016	\$285,256,214	215,267
2004	\$102,033,717	\$457,529,651	309,637
2005	\$183,271,404	\$795,799,010	453,131
2006	\$275,198,000	\$1,190,122,000	616,528
2007	\$383,500,000	\$1,687,600,000	838,754
2008	\$587,654,286	N/A	1,160,000

Figure 4 - Carrillo, 2009, Growth of Compartamos: 2002-2008

It is interesting that Compartamos was able to expand at such a rate despite public scrutiny on accounts of predatory tactics (Carrillo, I.R., 2009). The CEOs of Compartamos, Danel and Labarthe, defended their company by arguing that microfinance does not have to be one-dimensional (Danel, C. & Labarthe C., 2008). Banco Compartamos claims that microfinance can serve more than one bottom line and can benefit both investors and clients. Nonetheless, to expand and generate capital, investors need to be lured by profitable investments. Therefore, high profits must be secured (Carrillo, I.R., 2009).

The commercialized model of microfinance maintains similar features to modern capitalistic philosophy - as profits rise and clients increase in number, loans need to meet the needs of both clients and investors. In the interview presented previously, Mr. Chocano argues that, “The potential impact of microfinance on alleviating poverty lies in its capitalist system. Through the market economy, levels of extreme poverty have been reduced to levels never before achieved by humanity” (A. Chocano, personal communication, March 14, 2023). Thus, I believe he would think that the commercialized process has the ability to yield a higher income while maintaining a social impact.

Banco Compartamos has publicly stated that their business framework is aligned with traditional finance rather than structuring it towards poverty alleviation (Danel, C. & Labarthe C., 2008). If a commercialized microfinance institution expands, through logic of the free-market model, the service is good enough to make the entire client-base happy. If this is not the case, then clients would leave Compartamos and find an alternative financial service provider (Carrillo, I.R., 2009). Furthermore, through this model, there are many winners: clients benefit from the loan, investors see full recovery of their investments, and the microfinance institution should generate a degree of profitability. The increased amount of revenue allows for high

growth. This would allow microcredit institutions to expand their outreach thereby increasing access to credit in more communities. This in turn should decrease poverty levels for the communities the institution serves (Carrillo, I.R., 2009).

Deborah Drake and Elisabeth Rhyne's book argues that a financial-system approach can benefit the global poor more than a subsidy approach (Drake, D. & Rhyne, E., 2002). Rather than shunning the commercialization of the microfinance industry, they advocate welcoming it. They believe that outreach is the principal factor in pulling the greatest number of people out of poverty. Therefore, commercialized models outperform socially-oriented microfinance institutions (Drake, D. & Rhyne, E. 2002). As Mr. Chocano mentioned, the pro-commercialization model can have upsides, it is just that, "...the negative derivatives of microfinance are heard louder and more frequently, such as over-indebtedness, fraud, usury, conflicts of political and business interests, or possible personal pressures in group loans" (A. Chocano, personal communication, March 14, 2023).

6.2 Anti-Commercialization Argument

Muhammad Yunus, a prominent figure in microfinance, strongly criticizes the commercialized approach that some microfinance institutions have adopted. He argues that microfinance institutions should keep their focus on the primary goal of poverty alleviation. Contrary to Mr. Chocano's argument that the capitalistic system benefits the microfinance industry, Yunus argues that the commercialized model is reminiscent of neoliberal ideology, which fails to acknowledge the multidimensionality of human beings and solely focuses on individual gains and benefits (Carrillo, I.R., 2009). According to Yunus, such a model perpetuates poverty and economic marginalization (Yunus, M., 2009). To counteract the

exclusivity of the capitalistic world market, Yunus suggests that socially-conscious reform be incorporated into traditional business practices (Yunus, 2009).

Advocates of the socially-oriented microfinance model believe that access to credit is a fundamental human right and that the poor can benefit from productive labor if equipped with the tools that generate opportunities. In spite of this, the poor have been financially isolated due to the capitalistic global economy, hindering their access to competition and advancement. The trend towards commercialization could transform microfinance as a tool that emerged to alleviate poverty into a program that benefits the global elite, leading to the risk of perpetual exclusion (Carrillo, I.R, 2009).

Commercialized microfinance institutions such as Banco Compartamos, Banco Azteca, and Financiera Independencia earn high profits, but their practices have come under scrutiny for ethical reasons. Such institutions have led to financial destruction for many people, leaving them with nothing, including their homes. In contrast, socially-oriented models have more relaxed payment systems and do not take personal belongings as collateral. For example, Mr. Chocano's workplace, MICROWD, has a payback period of up to two years and does not take personal belongings as collateral.

Additionally, many commercialized microfinance institutions use practices that are considered illegal or unethical in traditional banking, such as providing false information, unlawful repossession, and charging usurious interest rates (Lewis, J., 2008). Compartamos argues that its interest rates are competitive compared to traditional Mexican banks, but Yunus disagrees, stating that a real microfinance organization needs to keep interest rates as low as possible. Jonathan Lewis, the founder and CEO of the socially-oriented MicroCredit Enterprises, explains that traditional finance models use high interest rates to stimulate investment, growth,

and competition, resulting in better rates for consumers (Lewis, J., 2008). But, this is not the case for microfinance institutions, as competition has not led to decreased interest rates due to the high demand for microfinance services. There are over 2.5 billion people without access to financial services, with microcredit firms only meet 10 percent of this demand (Lewis, J., 2008).

The idea that industry competition stimulates growth is a misconception that is evident in traditional American industries like steel, oil, telecommunications, and transportation, where prices have not decreased as a result of competition (Lewis, J., 2008). Instead, these industries have resorted to finding loopholes through regulatory obligations to keep prices high and generate enormous profits, further isolating the poor from many goods and services. Despite this, Lewis points out that it is possible to run a socially-oriented and sustainable microfinance institution. For example, CRECER is a Mexican microfinance institution that serves 90,000 rural and peri-urban clients in 7,000 village banks with a loan portfolio of \$23 million (Lewis, J., 2008). CRECER has turned a profit for decades and offers a diversified set of financial products and services, including educational, health, financial, and skills training, as well as a free legal team (Lewis, J., 2008).

7. CONCLUSION

Responsible consumption has become a prevalent issue in the media as large corporations have been criticized for their unethical practices. Informed consumers have become increasingly aware of the origins of their products, considering factors such as child labor, sweatshop working conditions, and exploitation of natural resources. However, this same level of consideration should be applied to investment choices. It is crucial to consider who needs opportunities the most, and who has been repeatedly denied access to financial products and services.

Millions of people around the world are waiting for someone to believe in their potential and provide them with the tools for success. The poor are often overlooked, but they have the potential to transform national economies by contributing valuable productivity and human capital. In Mexico, where there is a large informal sector and limited access to credit, microfinance institutions have the potential to alleviate poverty and promote economic growth.

In my interview with Alvaro Chocano, he argues that the capitalistic model is how microfinance thrives, but I think the commercialized model of microfinance presents significant ethical concerns. As can be seen with several Mexican microfinance firms accused of employing illegal and unethical practices, including high interest rates, untrue information, and unlawful repossession. Commercialization has the potential to benefit the global elite at the expense of the poor, perpetuating their exclusion from the economy. This can be detrimental to the very people that microfinance is designed to help because the poor often have limited access to credit and may not be able to repay loans at unfair interest rates.

Instead, socially-conscious microfinance institutions should be at the forefront of the microfinance industry in Mexico. The social bottom line approach allows microfinance

institutions to focus on providing sustainable financial services to the poor, rather than maximizing profits. This can help ensure that microfinance institutions are accountable to their clients, and that they are operating in a way that benefits the poor. Access to credit should be viewed as a fundamental human right, and microfinance should be seen as a tool for poverty alleviation, not a profit-making enterprise. By providing relaxed payment systems and avoiding the use of personal belongings as collateral, socially-conscious microfinance institutions can offer a viable alternative to the commercialized model. This can help ensure that microfinance institutions are accountable to their clients, and that they are operating in a way that benefits the poor.

It is crucial to move away from the commercialized model and focus on socially-oriented microfinance institutions, which offer a diversified set of financial products and services, including educational, health, financial, and skills training. These institutions have the potential to transform the lives of millions of people in Mexico, providing them with the tools and opportunities they need to escape poverty and contribute to the economy. Only after reaching out to its fullest extent can Mexico start thinking about generating competition through commercialization. Therefore, the microfinance environment in Mexico should prioritize socially-conscious microfinance institutions at the forefront of the industry.

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