Financial Inclusion and Contract Terms: Experimental Evidence from Mexico

Sara G. Castellanos† Diego Jiménez-Hernández‡ Aprajit Mahajan§ Enrique Seira¶

First draft: November 25, 2015
This draft: August 7, 2018

Abstract

This paper provides evidence on the difficulty of expanding access to credit through large institutions. We use detailed observational data and a large-scale countrywide experiment to examine a large bank’s experience with a credit card that accounted for approximately 15% of all first-time formal sector borrowing in Mexico in 2010. Borrowers have limited credit histories and high exit-risk – a third of all study cards are defaulted on or cancelled during the 26 month sample period. We use a large-scale randomized experiment on a representative sample of the bank’s marginal borrowers to test whether contract terms affect default. We find that large experimental changes in interest rates and minimum payments do little to mitigate default risk. We also use detailed data on purchases and payments to construct a measure of bank revenue per card and find it is generally low and difficult to predict (using machine learning methods), perhaps explaining the bank’s eventual discontinuation of the product. Finally, we show that borrowers generating a favorable credit history are much more likely to switch banks providing suggestive evidence of a lending externality. Taken together these facts highlight the difficulty of increasing financial access using large formal sector financial organizations.

Keywords: Financial Inclusion, Credit cards, Default risk, Mexico. Word Count: 20,064

JEL: D14, D18, D82, G21.

*We like to thank Bernardo Garcia Bulle and Isaac Meza for their outstanding research assistance. We thank Stephanie Bonds, Arun Chandrashekhar, Liran Einav, Marcel Fafchamps, Melanie Morten, Sirenia Vazquez, and Carlos Serrano for their helpful comments. We thank Ana Aguilar and Alan Elizondo for their support. We also thank seminar participants at Banco de Mexico, the Central Bank of Armenia, Columbia, ITAM, The Naval Postgraduate School, Stanford, UC Berkeley, Yale, USC, UC Merced, BREAD (May 2018), UC Davis and the Barcelona GSE Conference (June 2018). All errors are our own. A previous version of this paper was circulated under the title “Financial Inclusion with Credit Cards in Mexico.” The views expressed herein are those of the authors and do not necessarily reflect the views of Banco de México.

†Banco de México, sara.castellanos@banxico.org.mx.
‡Department of Economics, Stanford University, diego.j.jimenez.h@gmail.com.
§Department of Agricultural & Resource Economics, UC Berkeley, aprajit@gmail.com.
¶Centro de Investigación Económica, ITAM, enrique.seira@gmail.com.