The Blended Walmart Business Model: MoneyCenters, Banco Walmart de México, and the Formidable Challenge Facing Credit Unions

Robert D. Manning, PhD
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Progress is the constant replacing of the best there is with something still better!

— Edward A. Filene

Deeply embedded in the credit union tradition is an ongoing search for better ways to understand and serve credit union members. Open inquiry, the free flow of ideas, and debate are essential parts of the true democratic process.

The Filene Research Institute is a 501(c)(3) not-for-profit research organization dedicated to scientific and thoughtful analysis about issues affecting the future of consumer finance. Through independent research and innovation programs the Institute examines issues vital to the future of credit unions.

Ideas grow through thoughtful and scientific analysis of top-priority consumer, public policy, and credit union competitive issues. Researchers are given considerable latitude in their exploration and studies of these high-priority issues.

The Institute is governed by an Administrative Board made up of the credit union industry's top leaders. Research topics and priorities are set by the Research Council, a select group of credit union CEOs, and the Filene Research Fellows, a blue ribbon panel of academic experts. Innovation programs are developed in part by Filene i^3, an assembly of credit union executives screened for entrepreneurial competencies.

The name of the Institute honors Edward A. Filene, the "father of the U.S. credit union movement." Filene was an innovative leader who relied on insightful research and analysis when encouraging credit union development.

Since its founding in 1989, the Institute has worked with over one hundred academic institutions and published hundreds of research studies. The entire research library is available online at www.filene.org.

Acknowledgments

Over the course of the last two years, this project was nurtured and finally completed due to the foresight, strategic contributions, and patience of the senior leadership of the Filene Research Institute: Mark Meyer, CEO; George Hofheimer, chief research officer; and Ben Rogers, research director. Without their staunch support and commitment, this research project would not have achieved the depth and breadth that is necessary for fostering constructive debate over the challenges posed by the strategic expansion of Walmart into consumer financial services. It was their stewardship that enabled the study to address so many provocative questions, the answers to which will ultimately guide and shape the responses of the credit union system. Their willingness to tackle such an important topic and provide the time and necessary resources to complete the project highlights the important role that Filene plays in serving the credit union community.

The design and implementation of a binational and bilingual research project is challenging under the best of circumstances. The controversy over this topic and the general uncertainty surrounding the changing regulatory environment for retail banking in the United States made access to key policymakers and decision makers even more difficult to obtain. Furthermore, personal safety considerations in Mexico required the fieldwork to be conducted more discreetly by U.S. research staff. This was a potentially risky pursuit: Making inductive research inquiries into the Mexican financial system could have led the research team to inadvertently stumble onto illicit banking activities, which could have jeopardized their safety.

The research project essentially was comprised of two distinct phases. The first focused on Walmart's strategy for acquiring a nationally chartered banking institution, its ongoing expansion into consumer financial services, and competition over potential new credit union members. These and other issues became the focus of a "call to action" colloquium for credit unions to begin planning new products, programs, and initiatives for attracting new members and better serving existing members. The conference was convened in November 2008 at the Rochester Institute of Technology's E. Philip Saunders College of Business. The well-attended program attracted credit union executives from across the country and was published as a 2009 Filene Institute research report, *Trends and Future Directions in Consumer Financial Services: A Colloquium at Rochester Institute of Technology*. Molly Weimer and Thomas Upchurch of RIT's Center for Consumer Financial Services and Filene's Josey Siegenthaler were instrumental in the success of the colloquium.

After the RIT conference, the U.S. sections of the report benefited from the insights and contributions of several outstanding researchers: Steve Delfin, executive director of the CUNA Foundation; Stephen LaGrou, Esq., visiting professor of business law at RIT; Dr. Anita Butera, Esq., assistant professor of criminal justice at Marist College; Michael J. Herrmann, research analyst at Newtonian Finances, Ltd.; and Thomas Upchurch, senior project manager at the Responsible Debt Relief Institute. This multidisciplinary scope provided the analytical backdrop for the historical–institutional investigation of Walmart's entry and rapid expansion into Mexican consumer financial services.

The final chapters of the report examine the unique features of the Mexican banking system, which provide the context of the recent approval of nonbanks entering retail banking and the performance of Banco Walmart de México Adelante during the current "free trade" NAFTA regime. We are indebted to the assistance and collegiality of Carlos Sesma, Jr., and Joanna Estrada Schtuz of the Redport Consulting company in Mexico City, who shared their earlier findings on Walmart's business strategies in Mexico. Also, Professor Arturo Alvarado Mendoza, PhD, of El Colegio de México, provided sage guidance in the fieldwork phases in Mexico. And, Patricia Pena Berges of the Responsible Debt Relief Institute provided superb analysis of the Mexican consumer banking statistics and the opaque reports of Walmart's banking operations in Mexico. Finally, special thanks go to Molly Weimer of the Responsible Debt Relief Institute for organizing the complex file formats into a single, integrated manuscript, and to Josey Siegenthaler of Filene for her laborious efforts in finalizing the production of the report while preparing for her own impending "labor."

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Executive Summary and Commentary

by Ben Rogers,
Research Director

In July 2010, news outlets around the country ran a short, straightforward story from the Associated Press: *Sam's Club will offer small-business loans*. The story's author culled most of the program details from the store's press release: Sam's Club would partner with nonbank lender Superior Financial Group to offer online loans of $5,000–$25,000; new adopters would get a $100 discount on the application fee; and the program would focus on minority-, woman-, and veteran-owned businesses. The end of the story included a brief description of the 2007 controversy over whether to allow Walmart, Sam's Club's corporate parent, to charter its own bank.

The Sam's Club story is a far cry from the front-page drama that played out in 2007, when tough FDIC hearings and clamoring interest groups succeeded in checking Walmart's financial services ambitions. After the painful 2007 denial and as recently as 2009, Walmart's president of financial services has insisted, "We don't have any plans for anything relative to a bank" (Aspan 2009). But this report shows that Walmart doesn't need a bank charter to become a force in financial services. And when it does have a charter, as it does in Mexico and as it may eventually in the United States, it can be a powerful force indeed.

What Is the Research About?

The Blended Walmart Business Model knits together the many angles of Walmart's involvement in financial services, from its 2007 charter travails to its foray into Mexican banking and, most importantly, to its clear long-term strategy of providing financial services to ever more of its many retail customers—with or without a formal bank charter. The author, Dr. Robert Manning, brings a critical eye to Walmart's claims of low-price leadership in financial services. He also makes a compelling case that Walmart is doing just fine without its U.S. bank charter and that even though today the retailer mainly offers ancillary financial products, it will all too soon be playing in credit unions' traditional business model of deposits and loans. An industry already nervous about where its next generation of members will come from cannot afford to ignore the competitive threat brewing at the local Supercenter.

What Did the Research Reveal?

Walmart is nothing if not a patient strategist. Setbacks with its bank charter did not force it to abandon its financial services goals. Instead, it has retuned its approach by offering financial products through partnerships in the United States and through an independent charter in Mexico. Research highlights include:

- Walmart still wants a bank charter. Together with finance and penalty fees from the outstanding balances on Walmart-issued credit cards, Walmart could easily earn over $1.3 billion (B) annually from its payment card system and portfolio of customer credit card balances. It could save billions more owning the bank on the issuing end of its interchange fees and even more by setting up a proprietary system to compete against the Visa and MasterCard duopoly.
- Walmart already offers a compelling range of benefits to potential banking customers. Walmart's ability to lure customers from credit unions while attracting unbanked consumers is straightforward: location, hours of operation, welcoming atmosphere, familiar customer service, reasonable and clearly explained fees, and fast transactions.
- Walmart wants to be in finance because it pays. The profit margins of Walmart's traditional retail sales average 23.7% gross and 3.5% net, whereas the averages for comparable financial services companies range from 14% to 38% gross and 6% to 9% net.

What Are the Credit Union Implications?

It has been comfortable for credit unions to ignore Walmart as a competitor to date, because the products it offers—check cashing, prepaid cards, money wires—are marginal products for them. With or without a bank charter, though, it is likely that Walmart will gravitate toward credit unions' core business lines in demand deposits, auto loans, and, as proven by the Sam's Club story, small-business loans. The multinational brings three advantages that are difficult to counteract: brand recognition, convenience, and the ability to cross-promote its retail offerings with its financial products. Walmart's U.S. MoneyCenters are already attracting customers who, in another era, would likely have gravitated toward credit unions: young, blue-collar, early-career shoppers who come for the low prices and choose the plastic cards, money orders, and check-cashing services because they are convenient.

The response? Dr. Manning calls for credit unions to respond with the value proposition that is still in their favor: a better deal. Despite Walmart's low fees on many products, its credit cards are far more expensive than average and, as shown in its Mexico operations, the company usually pays far less on deposits. But even the best deals need an audience, so the second call is for a concerted marketing campaign—indeed, one that mirrors the successful campaign

Walmart itself has waged in Mexico. There, the company's initial regulatory and public relations victories have come from easy points scored by contrasting its prices and services with those of "greedy" banks.

The author, aware that national credit union marketing initiatives have been proposed, debated, and usually abandoned for at least as long as there have been credit unions, nevertheless laments credit unions' struggle to juxtapose their business practices with those of banks and to switch big banks' customers over. The iron has never been hotter. But even without a coordinated national campaign, individual credit unions cannot afford merely to check the rate pages of other local banks. They must also watch and respond to the products Walmart keeps rolling out—in the United States and in Mexico. Small-business lending at Sam's Club is surely just the beginning.

Robert D. Manning, PhD

Robert D. Manning is founding president and CEO of the nonprofit Responsible Debt Relief (RDR) Institute, founder of the educational nonprofit DebtorWise Foundation, and past research professor and director of the Center for Consumer Financial Services, Rochester Institute of Technology. Author of the widely acclaimed *Credit Card Nation: America's Dangerous Addiction to Credit* (2000), which received the 2001 Robert Ezra Park Award for Outstanding Contribution to Sociological Practice, Dr. Manning is a specialist in the deregulation of retail banking, consumer finance, comparative economic development, immigration, and globalization. His most recent book is *Living with Debt: A Life-Stage Analysis of Changing America's Attitudes Toward Consumer Credit* (2005). Dr. Manning is also a research fellow at the Filene Research Institute.

Dr. Manning is a frequently invited expert before U.S. Congressional Committees and federal regulatory agencies, and his research has influenced public policy debate on the statutory regulation of retail banking and consumer debt in the United States and other countries, including the CARD Act of 2010. The latter is the first major regulatory reform of the U.S. credit card industry in over 20 years. He has also served as an expert witness in numerous lawsuits against unscrupulous policies of the commercial credit card industry, nonbank consumer lenders, and the debt settlement industry. His pathbreaking RDR Household Debt Capacity Assessment algorithm/software is the basis of the RDR/DRP program, which offers a nonprofit alternative to debt settlement companies and consumer bankruptcy. A documentary based on his research, *In Debt We Trust: America Before the Bubble Bursts* (www.indebtwetrust.com), was released in March 2007. Dr. Manning's popular Web sites, www.creditcardnation.com and www.responsibledebtrelief.org, include research, public policy analyses, and educational programs.

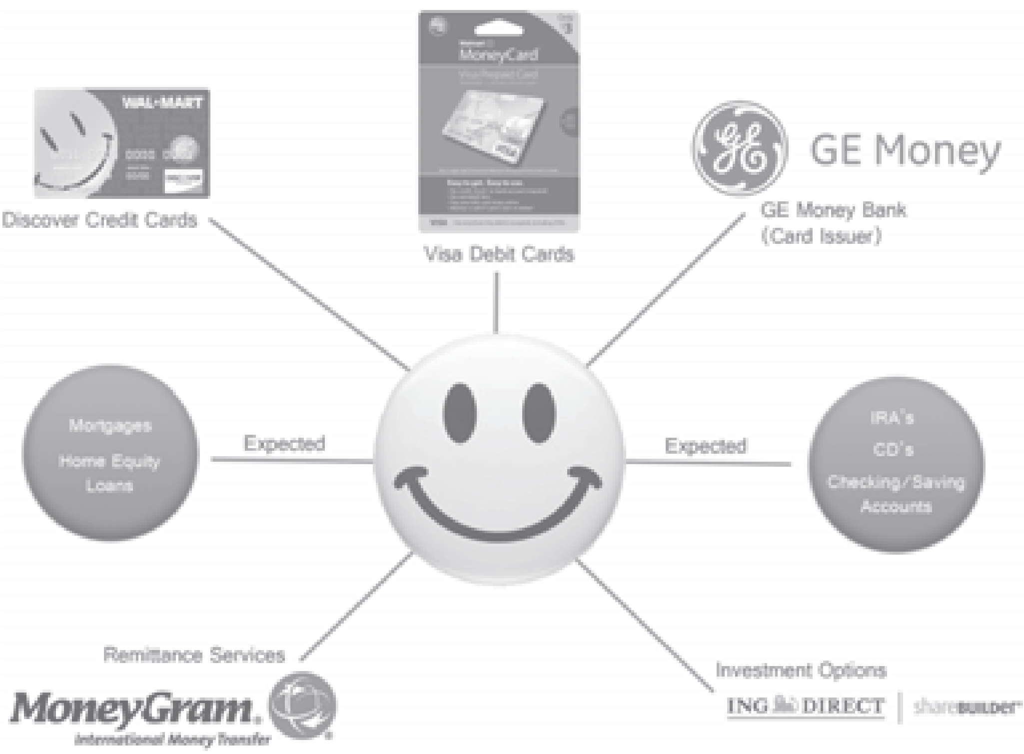
CHAPTER 1
Introduction

As the largest retailer in the world and a profit-driven company, Walmart is constantly on the lookout for growth opportunities. Faced with diminishing returns in its traditional retail business, the company is pursuing multiple paths to a profitable—and formidable—retail financial business.

Walmart: The World's Most Successful Retailer

From the small-town southern culture, free-market principles, and evangelical Christian values espoused by founder Sam Walton when he opened his first store in 1962 (Walton and Huey 1993; Slater 2004; Soderquist 2005), Walmart has soared from its humble Arkansas origins to become the largest private employer and grocery retailer in the United States. Incredibly, as its state-of-the-art global production and supply chains have become the envy of even

Figure 1: Walmart's Current Relationship Web in Financial Services: What Else Could Be in Store?



the most sophisticated multinational corporations, the Walmart brand has become synonymous with American dominance of the global economy and the ascension of the consumer society. From its headquarters in Bentonville, Arkansas, Walmart has vanquished its competitors throughout the United States and now is aggressively expanding into Latin America, Europe, and Asia. Walmart's international growth has experienced mixed success, as it has closed some stores in Germany and Japan while encountering a steep learning curve in China. Over the last decade, Walmart's overseas revenue growth has been nearly four times greater than in the United States.

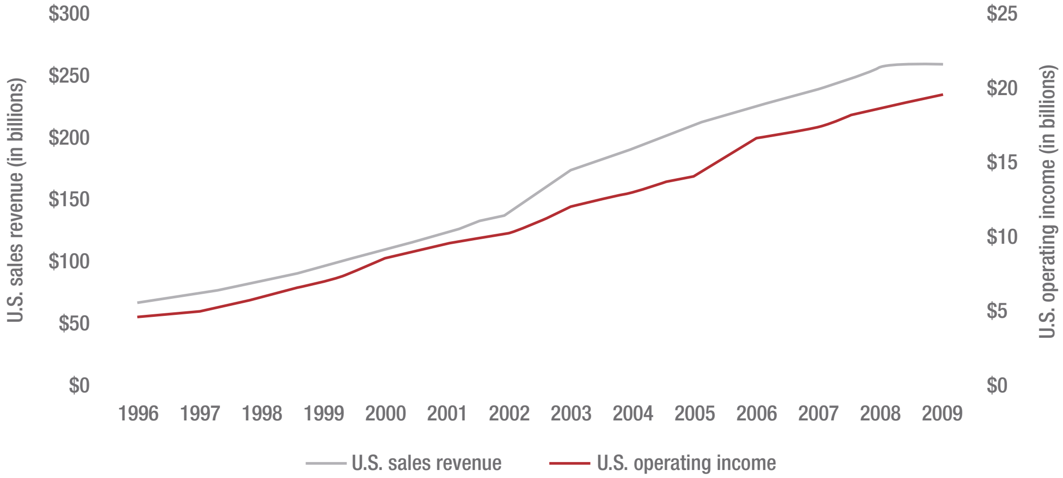
Like Warren Buffett's Berkshire Hathaway investment company, Walmart's major advantage is also its disadvantage: its enormous corporate size. In order to achieve its annual growth objectives, Walmart must enter many new retail markets *and* offer new product lines simply to maintain is average growth rates. And, as demonstrated by the 2007 recession, these corporate growth objectives are increasingly difficult to achieve as Americans adjust to the new economic realities of tighter job and credit markets as well as changes in their standard of living.

Sam Walton's mantra, "the customer comes first," continues to be his visionary legacy as it defines the corporate ethos and business practices of Walmart (Ortega 1998; Fishman 2006; Lichtenstein 2006). Indeed, Walmart does not simply "sell" a product line to its customers in order to maximize corporate profits. Rather, Walmart leverages its vast scale economies and market muscle in order to obtain—on behalf of its customers—lower prices, higher quality, and faster delivery in pursuing its goal of making the "American dream" more accessible. After all, who can criticize its corporate motto: "Save Money, Live Better"? Nevertheless, the mushrooming Supercenters deflect attention from the fundamental issue of Walmart's growth. What are the costs of the individual benefits of the "Walmart effect" and its unrelenting obsession with lowering its expenses?

The decades-long controversy over Walmart is infused with contradictions and ironies. The company that offers "everyday low prices" to its customers provides compensation so low that many employees must rely on food stamps and public health care to survive. Management careers are promoted as rewarding "partnerships" in the Walmart family yet provide little time for personal life and household responsibilities. Corporate marketing campaigns that promote strong communities and trumpet benevolent corporate contributions belie the penurious philanthropic reality faced by local community organizations that embrace the "Walmart way." The "Buy America" campaigns extol the virtues of small-town life, yet Walmart's aggressive expansion policies (fueled by tax relief and other public subsidies) entail a scorched-earth policy toward the Main Street small-business sector that becomes collateral damage in the battle over low prices. The committed corporate citizen that promotes environmental "green" policies turns a blind eye to its global production/supply chains that sacrifice fragile ecosystems for cost-cutting efficiencies. And, the highly touted promise of local economic development contrasts sharply with the reality of undocumented construction and janitorial workers, discriminatory hiring and firing practices, uncompensated overtime, and outsourced employment including child labor. Not to mention a free-market-driven, evangelical religious philosophy that justifies hard-nosed business decisions as being in the best interest of its customers while censoring or refusing to sell products that it deems objectionable—regardless of the demand by its customers (Ortega 1998; Fishman 2006; Lichtenstein 2006).

During the current recession, Walmart's U.S. sales have experienced positive albeit marginal growth, from $255.75B in 2008 to $258.23B in 2009 (0.9%), while its operating income has risen impressively (5.2%)—from $18.56B to $19.52B (see Figure 2). In comparison, international sales have increased from $98.84B in 2008 to $100.11B in 2009 (1.3%), while international operating income increased only 1.9% in this period (Walmart 2010b). Clearly, Walmart recognizes that the limits of its robust U.S. grocery/merchandise growth are on the horizon. Offering more upscale product lines and entering higher-income communities may generate some future growth opportunities, but with only modest long-term benefits. In order for Walmart to remain a global business juggernaut, it must adeptly expand its international retail networks *and*

Figure 2: Walmart's U.S. Sales Revenue and Operating Income, 1996–2009



Source: U.S. Securities and Exchange Commission, EDGAR Online. "Wal-Mart Stores SEC Filings (10-k annual reports), 1996–2010." www.sec.gov/edgar.shtml.

integrate its rapidly growing consumer banking operations. In view of the healthy financial situation of Walmart, it has a strategic opportunity to create a synergistically "blended" business model that could become even more formidable than the complementary consumer products/banking model pioneered by General Electric before it spun off its GE finance division.

So, what are the implications of Walmart's blended business model to local banks and credit unions? Can credit unions and community development banks attract unbanked households that shop at Walmart for their groceries and other household necessities? Can credit unions compete with national online and mobile banking systems that appeal to young adults and the next generation of credit union members? Will Web-based banking services replace the need for costly brick-and-mortar credit unions and supplant local financial institutions? The answers to these questions—including the key role that Walmart will play—underscore the urgency of developing a nationwide credit union action plan. Indeed, the looming specter of Walmart's financial services along with its blended business model (synergies of retailing *and* banking) may render this debate moot if credit unions do not respond quickly, proactively, and innovatively. Although the U.S. Congress and federal bank regulators have been able to preserve the tenuous legal separation between commerce and banking, the gap is rapidly narrowing with strategic joint ventures and banking partnerships. After all, who would have thought a decade ago that you could apply for a mortgage while getting a gallon of milk from a Kroger grocery store or obtain a business line of credit (GE Money) while shopping at Walmart, not to mention a Rapid Advance Loan from H&R Block after preparing your taxes?

What innovative approaches to traditional services and what new services is your credit union developing that will differentiate it from commercial banks and the generic financial services offered by Walmart?

Figure 3: A Walmart Credit Card Offer

The times are changing and quickly. The world's retail innovator is committed to reengineering its own formidable retail business model. In the process, Walmart will fundamentally change the consumer financial services marketplace and marginalize the role played by credit unions. As revealed by the lessons from Banco Walmart de México Adelante, the question is not *if* Walmart's consumer financial services will be offered in your town, but *when*! Ultimately the key is, what is *your* credit union doing *today* in preparation for Walmart's impending arrival? What innovative approaches to traditional services and what new services is your credit union developing that will differentiate it from commercial banks and the generic financial services offered by Walmart? In response to the Walmart blended business model, what strategic partnerships are being forged with other retailers and community organizations? What welcoming social spaces can you develop that will attract the next generation of credit union members? If the answer is very little, then you may be shocked when few of your members care when your credit union's services are replaced by a MoneyCenter at the local Walmart Supercenter.

CHAPTER 2
Walmart's Entry into Consumer Financial Services: A Brief History

Walmart would win important advantages, like reduced interchange expenses and more profitable in-house financing, with the acquisition of a U.S. bank charter, but its efforts to do so have met regulatory roadblocks at every turn. Walmart, however, doesn't have to operate its own bank charter to make inroads into consumer financial services. It is already well down that path.

Walmart has been pursuing three parallel paths in its efforts to enter the mainstream U.S. consumer financial services industry. First, Walmart has developed an increasing array of transactional financial services (e.g., money orders, money wires/transfers, and check cashing) since the late 1990s in response to customer demand—especially among customers without banking relationships and accounts with depository institutions. These services compete with "fringe" or "second-tier" financial services (Caskey 1996; Manning 2000; Peterson 2004; U.S. FDIC 2009) such as cash-checking outlets, pawn shops, and Western Union. With the rapid growth of these high-cost, nonbank financial services providers—including consumer lending such as payday loans via "rent-a-banks"—Walmart has become a transitional banking gateway by providing its customers with low-cost transactional financial services in its stores. Second, by leasing retail space to banks and credit unions in its MoneyCenters, Walmart has guided unbanked and underserved consumers such as new immigrants to first-tier financial services providers. Not surprisingly, this approach of partnering with credit unions and banks to offer branch banking services in MoneyCenters has been more often lauded rather than criticized. As a result, Walmart's short-term strategy of partnering with financial institutions that offer financial services in its MoneyCenters has mitigated criticisms of its future competitive advantages in the U.S. consumer financial services marketplace. In the long term, as illustrated by its branch banking strategy in Mexico (see Chapter 4), Walmart's MoneyCenters pose a formidable competitive threat to credit unions and regional banks—especially with the increasing geographic mobility of the working poor and struggling middle-classes as spurred by the ongoing recession.

> Walmart has followed three parallel paths in its attempt to enter the mainstream retail financial space: selling fee-based transactional products, often with partner companies; leasing space to traditional banks and credit unions; and, most directly, buying or chartering its own bank.

The third strategy of Walmart to offer consumer financial services poses the greatest threat to the future viability of the credit union system as well as the survival of regional banks. Since the enactment of the Financial Services Modernization Act of 1999 (Gramm, Leach, Bliley [GLB] Act), Walmart has aggressively sought to acquire a chartered depository banking institution in order to directly offer branch banking services throughout the United States. This landmark legislation effectively ended Depression-era banking regulations such as the Glass-Steagall Act of 1933, which prohibited commercial/retail banks from combining with investment banking, insurance, and brokerage companies (cf. Barth, Brumbaugh, and Wilcox 2000). The new law consecrated the illegal acquisition of Citibank by Traveler's Group insurance company in the creation of the ill-fated Citigroup union (Manning 2000); Citi subsequently sold its Traveler's Group subsidiary due to its lower profit margins. In the process, this legislation unleashed a decade of unprecedented deregulatory policies that propelled the U.S. banking sector's merger and acquisition frenzy, as well as the housing bubble and soaring stock market prices that were facilitated by the "easy" credit policies of U.S. Federal Reserve Chairman Alan Greenspan. Together, these trends reinforced the "irrational exuberance" that defined the decade and ultimately led to the "unexpected" systemic collapse of the U.S. financial system in the fall of 2008 (Greenspan 2008; Fleckenstein and Sheehan 2008; Zandi 2008).

The enactment of the GLB Act of 1999 facilitated the extraordinary industry concentration that spawned the emergence of trillion-dollar bank holding companies and the prudential regulatory concern of "too big to fail." By permitting one-stop shopping, moreover, it produced a new conglomerate bank structure that offers a full range of cross-marketed consumer financial, insurance, and investment banking services. This new organizational form underlies the emergent financial services chasm that arose from the profitability gap between high- and low-income communities. That is, the new conglomerate banks focused the marketing of their larger array of financial services to middle- and upper-income consumers rather than riskier, less profitable, low-income households—especially urban minorities. By segmenting the consumer financial services market based on the yields of these cross-marketed product bundles, the conglomerate banks withdrew from lower-income neighborhoods and concentrated on higher-income communities—a crucial market segment for credit unions that are less competitive in the "one-stop" price-cutting wars. As a result, credit unions have encountered far less competition for lower-income consumers but must grapple with the challenges of recruiting lower-revenue-generating members from immigrant and minority communities. In the meantime, second-tier or fringe banks have proliferated in this financial services gap while many credit unions have focused on modifying their consumer lending policies in order to compete with commercial banks.

Figure 4: Timeline of Walmart's U.S. Bank Charter Efforts

With the public scrutiny of U.S. banking regulations and the TARP bailout program, the credit union system has had the unique opportunity to emphasize that its lending policies (mandated cap of 18% APR for federally chartered credit unions) and lack of relationship to the "shadow" banking system have played an important role in the ongoing stabilization and recovery of the American financial system. Unfortunately, credit unions have tempered their criticisms of commercial banks and have not effectively promoted the virtues of the credit union system by clearly differentiating their different services, policies, and philosophies to the American public. This is an historic opportunity that will soon be lost with the impending political and economic recovery of the largest commercial banks. Indeed, some critics have argued that the deregulatory policies arising from the GLB Act, together with the financial engineering of structured investment products and derivatives contracts that were aggressively marketed by unregulated shadow banks like Merrill Lynch, were major contributors to the systemic collapse of the U.S. banking system in fall of 2008 (Fleckenstein and Sheehan 2008; Zandi 2008). Critics include past U.S. Secretary of Treasury Paul Volker, who has ardently advocated for stricter regulation of the financial sector, with particular emphasis on imposing limits on "broad banking" activities of bank holding companies, in the spirit of the Glass-Steagall Act and its amendments (Uchitelle 2010a, 2010b). Hence, as the political pressure for greater bank regulation wanes over the demands for job creation, credit unions may realize—too late—that a crucial regulatory objective has been within its grasp: reinforcing the historic separation of industry from banking, which is the focus of this report.

For Walmart, the new guidance provided by the Congress with the enactment of the GLB Act in 1999 and the deregulatory orientation of federal bank regulators in the late 1990s suggested that it had a green light to enter the financial services industry through the regulatory front door by acquiring a chartered depository institution. Indeed, the new law eliminated the cornerstone of the Glass-Steagall Act: prohibitions against industrial/insurance corporations owning commercial banks. That is, after the Great Depression of 1929–1933, Congress had acted historically to prevent a financial conflict of interest whereby a corporation could influence its bank subsidiary to make loans that were in the best interest of the company rather than the fiduciary interest of the bank (e.g., speculative investments, risky loans to clients). This is the fundamental issue of U.S. prudential banking regulation: maintaining the safety and soundness of the financial system. Consequently, without this key regulatory obstacle, Walmart began to actively explore the acquisition of a federally insured depository institution. In 1999, Walmart applied for the purchase of an Oklahoma savings and loan (S&L) company, Federal BankCentre. Walmart's proposed acquisition of the S&L galvanized the banking industry with such intense opposition that new federal legislation was enacted to prevent the transaction by banning commercial firms from purchasing thrifts (Leonhardt 2006). Disappointed, Walmart pursued a legally creative strategy in 2001 by forming a joint venture with the U.S. subsidiary of Toronto Dominion Bank. The Office of Thrift Supervision (OTS) again rejected its application by forcefully asserting the traditional regulatory concern that a commercial enterprise controlling a financial institution could exploit the relationship to the benefit of the parent company and thus undermine the safety and soundness of the banking system.

Undeterred, in 2002 Walmart applied to purchase an industrial loan company (ILC), Franklin Bank of California. With this financial institution, Walmart could embark on its long-term strategy of reducing its multibillion-dollar merchant interchange transaction expenses by managing card transactions through direct debiting of Walmart bank consumers' accounts as opposed to using the Visa or MasterCard payment interchange network. Walmart, by issuing its own credit card (currently offered by GE Money through the Discover and Visa transaction platforms), would receive the acquiring banks' share of the merchant interchange fee as well as the issuing banks' share of its customers' other credit card purchases. This would have been the first step in Walmart's transition from the Visa and MasterCard transactional networks to establishing its own independent system such as Discover and American Express. In Mexico, Walmart issues a MasterCard through its Banco Walmart subsidiary.

The acquisition of a depository banking institution solely for the purchase of issuing consumer credit and processing electronic payments could generate hundreds of millions of dollars in annual revenue for Walmart, plus hundreds of millions more in lower merchant fees.

As will be shown, the acquisition of a depository banking institution solely for the purchase of issuing consumer credit and processing electronic payments could generate hundreds of millions of dollars in annual revenue for Walmart, plus hundreds of millions more in lower merchant fees. However, Walmart's plan to purchase Franklin Bank was thwarted. This time the California state legislature passed a law that restricted ownership of state-chartered ILCs to financial companies (Daleiden 2007). The main issues, again, concerned safety and soundness questions as well as potential conflicts of interest and—more significantly—potential negative competitive effects of Walmart's entrance into the financial services industry. That is, Walmart could easily eliminate small competitors such as community development banks and become the only retail bank in many parts of the country.

Following other retail companies—such as GE Money, GMAC, and Target—Walmart responded by applying for its own ILC charter from the state of Utah in 2005 (see Figure 43 in the appendix). This strategy of entering the consumer financial services market through the ILC regulatory back door is novel but hardly unique. Instead, what distinguished Walmart's ILC application process was the imposition of more stringent regulatory standards compared to other commercial entities—especially retail competitors. For instance, retail rival Target was approved for an ILC charter in 2004. Overall, 58 insured ILCs operate in seven states (most in Utah and California) with year-end assets of $12B in 1995 climbing to $213B in 2006. Federal policy for supervising ILCs is set by the Garn-St. Germain Depository Institutions Act of 1982 and the Competitive Equality Banking Act of 1987. The former made all ILCs eligible for federal deposit insurance and replaced the prevailing case-by-case approval process of the Federal Deposit Insurance Corporation (FDIC). More significantly, it brought ILCs under the supervisory authority of both state and FDIC regulations. The latter act enabled ILC owners to avoid "consolidated supervision" of bank holding companies by the Federal Reserve Board (FRB) or OTS as long as the ILC is chartered in a state that requires FDIC insurance for deposits (Spong and Robbins 2007).

Not surprisingly, Walmart's application for federal deposit insurance for its proposed ILC in business-friendly Utah provoked fierce resistance from small commercial banks, credit unions, consumer groups, and even large money-center banks with regulatory concerns. Clearly, the GLB Act of 1999 had affirmatively answered the question of whether different financial services activities and enterprises would be allowed to intertwine. However, Congress specified that these new, complex corporate structures must be regulated as bank holding companies under the explicit consolidated regulatory powers of the FRB. Since Walmart's ILC application defied Congress's intent of maintaining the separation of banking and commerce and, in the process, sought to evade more stringent FRB regulatory oversight,[1] the FDIC convened three days of hearings to debate the Walmart request—an unprecedented action (Nolan 2006). In the meantime, other states immediately enacted laws that precluded ownership of ILCs by commercial businesses. The result was a six-month moratorium on all ILC applications (including those submitted by Home Depot and Blue Cross and Blue Shield), which was subsequently extended for another year (Daleiden 2007).

After contentious Congressional hearings, convened by the House Financial Services and Senate Banking Committees, and an aggressive corporate lobbying campaign that failed to sway public opinion, Walmart withdrew its ILC application in March of 2007. The most salient criticisms concerned:

- Potential abuses of the FDIC's federally insured deposit program (i.e., poor credit decisions by Walmart could lead to its ILC being forced to purchase these loans and shift losses to the U.S. government).
- Short-term reductions in ILC loan rates and fees could drive out existing banks and result in higher long-term prices.
- Lending preferences could negatively impact healthy competition by offering favorable credit terms to Walmart suppliers over their competitors.
- Competitive advantages for Walmart versus FRB-regulated bank holding companies due to the FDIC's weak examination and enforcement authority.
- Greater risk of a major financial impact on the U.S. economy if there is not rigorous supervision due to the size of Walmart's corporate operations.

For Walmart, the outcome of the FDIC hearing was disappointing but not unexpected. According to Jane Thompson, president of Walmart's Financial Services Division, "Wal-Mart is absolutely committed *not* to engage in branch [retail] banking . . . we expect the charter . . . to include conditions to prevent Wal-Mart from opening bank branches" (quoted in Adler 2009). A year later, following Congressional hearings on Walmart's ILC application, Thompson asserted, "At no stage did [Walmart] intend to use the ILC to establish branch banking operations as critics have suggested—we simply sought to reduce credit and debit card transaction costs." Although cognizant of these financial pressures, FDIC Chairwoman Sheila C. Bair, the federal regulator of ILCs, remained unconvinced:

> *Wal-Mart made a wise choice [to withdraw its ILC application]. This decision will remove the controversy surrounding their intentions. They don't need an ILC to play an important role in expanding access to financial services, they can do so by partnering with banks and other [financial services companies]. We look forward to working with Wal-Mart in meeting the need for low-cost financial services. (FDIC 2007)*

Thompson's response to the FDIC rebuke is instructive: "*Since the [ILC] approval process is now likely to take years rather than months*, we decided to withdraw our application to better focus on other ways to serve our customers. *We fully intend to continue to introduce*

Figure 5: The Debate over Walmart's Application for an ILC Bank

Pros	Cons
Could provide the unbanked or underbanked an opportunity to open a checking/savings account, which could evolve into banking relationships for modest-priced consumer loans and eventually auto loan and home mortgages at reasonable costs.	The combination of banking and retailing (Walmart is the world's number-one retailer) would create enormous advantages that would negatively impact future competition, prices, and credit access.
Low-cost, high-volume competitive strategy could provide people with bank accounts the chance to obtain various credit instruments at a lower cost. Increased competition results in better prices overall for consumers. Lower merchant interchange fees paid by Walmart would be passed on to consumers through lower prices.	Low-cost model could push many small community-based banks/credit unions out of business. Communities could be deprived of needed capital for growth by shifting deposits. Walmart selects specific geographic areas to provide loans and could withdraw in the future after driving out competitors.
Walmart would be regulated by the FDIC, which would guide millions of un- and underbanked consumers away from unregulated "fringe" banks and into the regulated financial services sector with more consumer protections.	Would *not* be regulated under consolidated supervision of Federal Reserve. Less stringent monitoring and enforcement powers of FDIC creates a competitive advantage over bank holding companies.
Target Corporation, one of Walmart's primary retail competitors, has an ILC charter for credit/debit card transactions.	Dangerous precedent of intertwining banking and commerce. Could create major problems for the U.S. economy and large taxpayer obligations if Walmart made bad financial decisions.

new products and services that champion those who deserve convenient, lower priced financial services" (Walmart 2007, emphasis added). Significantly, Thompson did not mention that while U.S. regulators were rejecting Walmart's ILC license in the spring of 2007, Mexican regulators were approving its bank charter for Banco Walmart with unrestricted branch banking activities. As will be shown in Chapter 4, Walmart's officially declared lack of interest in providing retail banking services in the United States contrasts sharply with its current policy of aggressively expanding its branch banking network and retail lending activities in Mexico.

CHAPTER 3
Walmart: Formidable Challenge of the Blended Business Model

Consumers, especially young ones, increasingly prize convenience in financial services. With its loyal customer base, Walmart has the nearly unprecedented opportunity to convert millions of its customers into banking clients; it has already done so with products like prepaid cards, money orders, and check cashing—all without a formal bank charter. An integrated Walmart system that pushes retail shoppers to MoneyCenters and MoneyCenter customers to retail purchases is a real threat to credit unions.

The blended business model being developed by Walmart is several steps removed from the basic in-house, consumer finance approach that is traditionally offered by retailers like Target to increase consumer demand and their core business sales (Calder 2001). Unlike Kroger's fragmented model of selling unrelated financial services to any retail customer simply to supplement corporate profits, Walmart is carefully integrating retail banking into a long-term global strategy. That is, it is expanding and cultivating its customer base by increasing its front-end bundles of financial products and services through a variety of banking partnerships, as well as back-end operations such as processing credit card, debit, and electronic check transactions. As illustrated by the operations of Banco Walmart, a depository institution chartered in Mexico in 2007, Walmart's retail branch banking activities suggest continued forward and backward integration of consumer financial services such as savings, lending (consumer and commercial), insurance, and investment programs. If successful, it is not unreasonable to forecast that in the future—given Walmart's international scale—it could expand into investment banking for packaging and selling its future consumer (credit cards, auto, mortgage) and commercial loan portfolios.

At the most basic level, the "open book" line of credit offered by small merchants, proprietary charge accounts offered by large corporate retail chains, and even resurgent retail layaway plans share a fundamental objective: providing consumer credit exclusively for in-store purchases. Like company-issued script that could only be used to pay for goods at the company store, early retail charge account programs promoted greater sales by providing in-store credit when household cash was scarce, such as between paychecks or during periods of high unemployment. By enabling households to satisfy their needs and occasionally their wants, retail credit became a key factor in reinforcing customer trust and loyalty to the merchant.

Historically, these retail credit programs were not expected to be profitable—even at 18% APR—due to high overhead and administrative expenses (Mandell 1990; Manning 2000). Not until the modern era of the revolving credit card (after the 1981–1982 recession) did credit cards consistently earn profits above the average return on relatively low-yield retail banking services. But how quickly the model of business profitability has changed in the consumer-driven economy! By the time Target offered its own Visa credit card in the late 1990s, its consumer credit division had become a major engine of corporate profitability. It increased consumer demand for Target retail products while generating impressive returns on its consumer lending portfolio. By 2007, Target's credit card division had become the tenth largest credit card issuer.

Unlike a proprietary retail credit card, which restricts the use of credit exclusively to the purchase of that retailer's products and services (*closed-loop* credit card), the "universal" Target Visa credit card contributes to greater corporate profits by reducing the expense of its retail merchant fees as well as earning finance charges, penalty fees, and even a share of merchant fees from purchases made outside of its chain of retail stores.

For Walmart, these transaction fees/revenues can exceed a billion dollars per year. For example, total merchant interchange fees for the entire credit card industry (Visa, MasterCard, American Express, Discover) exceeded $24B in 2008, plus several billion dollars in other debit-type point-of-sale (POS) fees (Card Industry Directory 2009). In addition, due to its high volume of checking account "paper" payments, Walmart could achieve considerable savings by streamlining its check conversion practices (Mann 2007). With total U.S. retail revenues of $256B in 2008, about 59% of Walmart's sales were paid by electronic payment cards, a retail volume of about $151B. At a highly discounted merchant interchange rate of 0.62% for debit and 1.43% for credit (Hough et al. 2009), Walmart paid approximately $1.6B in total merchant fees, assuming 60% paid with credit and 40% with debit.

Together with finance and penalty fees from the outstanding balances on Walmart-issued credit cards, Walmart could easily earn over $1.3B annually from its payment card system and portfolio of customer credit card balances.

By processing its retail charges through its own bank, Walmart could save about $800 million (M) in merchant fees as the acquiring bank.[2] In addition, if only one-fourth of these retail charges were made with Walmart bank-issued payment cards, it could save another $200M per year plus a share of the interchange fees generated by purchases made at non-Walmart merchants. Together with finance and penalty fees from the outstanding balances on Walmart-issued credit cards, Walmart could easily earn over $1.3B annually from its payment card system and portfolio of customer credit card balances. Note that these revenue projections from customer card payments are based on Walmart's current lower-income customer base.

Even if Walmart were not interested in offering other consumer financial services through its own branch banking network, the gains from a proprietary debit/credit card operations system more than justify its earlier efforts to acquire a chartered financial institution that offers retail banking services. Indeed, a blended business model that generates additional revenues from other consumer financial services offers unique cross-marketing opportunities for its retail operations as well. For example, discounted financial services such as introductory, 0% credit card interest rates could be offered to increase merchandise sales among retail banking customers while discount coupons or even prepaid payment cards for store merchandise could entice other traditional Walmart customers to purchase retail banking services such as a home mortgage or auto loan.

The market opportunity for nonbank providers of consumer financial services is the ability to earn high margin fees with lower risk while promoting consumer loyalty with a more diverse range of retail products and services. On the one hand, strategic partnerships with Walmart can offer retail banks a national network of standardized MoneyCenters where potentially 40 million un- and underbanked consumers can enjoy predictable, no-frills banking experiences—like a fast, inexpensive meal at McDonald's. For instance, the international expansion of Walmart retail stores has increased its global brand recognition and international sales. In the United States, this global brand awareness has not only expanded retail merchandise sales among immigrants (Fishman 2006; Lichtenstein 2006) but also the purchase of basic financial services, which includes a portion of the $250B market ($24B from the United States to Mexico in 2007) in cross-border remittances (Inter-American Dialogue 2007). In sum, the success of the blended Walmart business model reflects the decline of the small business sector (an important credit union market and membership base) and the growing popularity of combining personal financial tasks with other shopping activities—"one-stop" consumer shopping.

Walmart's ability to lure customers from credit unions while attracting unbanked consumers is fairly straightforward: location, hours of operation, welcoming atmosphere, familiar customer service, reasonable and clearly explained fees, and reasonably fast transactions (Advance America 2008). In addition to the pool of about 40 million un- and underbanked consumers, including millions of new immigrants, the ongoing recession has attracted new customers to Walmart, including higher-income, middle-class households. While most retailers have experienced same-store revenue declines over the last two years, Walmart's comparable in-store traffic has actually risen—nearly 2% over the second quarter of fiscal year 2010. During this period, over 20% of this customer growth was due to first-time Walmart shoppers and two-thirds of these shoppers returned at least once (Walmart 2009).

For credit unions, the socio-demographic characteristics of Walmart customers is significant since it mirrors the profile of new credit union members. According to George Hofheimer (2008), new credit union members are much more likely to be young, single minorities or immigrants at the beginning of their work careers earning lower, entry-level incomes. Hence, typical Walmart shoppers. Although they will eventually move up the career ladder and establish their own households with children, at this time they tend to patronize financial services providers that meet them on their own terms: 24/7 online services, instant text messages, mall kiosks, local coffee bar venues, or national ATM networks. The current generation of twentysomethings, moreover, is difficult to monitor and forecast as careers, technology, and fashion are changing at a furious pace, while corporate loyalty is a fleeting hook-up. If it seems like credit union member recruitment is a moving target for marketing and IT teams, it *is*, as Web-based social networking replaces face-to-face workplace modes of interaction. Today, the cell phone is rapidly morphing into an all-purpose microcomputer and personal digital assistant (PDA), while Facebook is replacing Friendster and tweets are replacing texts. Tomorrow, it may be the iPad or Kindle that becomes the primary mode of personal and professional communications.

> Walmart's ability to lure customers from credit unions while attracting unbanked consumers is fairly straightforward: location, hours of operation, welcoming atmosphere, familiar customer service, reasonable and clearly explained fees, and reasonably fast transactions.

Significantly, it is the contradictory duality of the customer experience at Walmart that is its corporate Achilles' heel. Beginning with the store greeter and the standardized organizational form of the Supercenter, Walmart superficially projects the small-town sense of familiarity and social connectedness that underlies its unique, customer-first fixation on low prices. Yet, the inability to deliver personalized service through a wider range of special/local products limits its market expansion and contributes to the consumer demand for a parallel sector of niche-based, customer-service-oriented small businesses. This point is crucial to the future success of those credit unions that will survive the aggressive expansion of Walmart into the consumer financial services marketplace. That is, the current trend of credit unions adopting underwriting, mortgage modification, and debt collection policies that mirror the commercial bank sector makes it more difficult for credit unions to distinguish themselves and thus attract consumers who are seeking alternative service providers. Like Walmart, credit unions that profess the primacy of members' interests will have to demonstrate this commitment through innovative new programs if they are going to effectively compete with the blended retail-banking model. This is illustrated by the flourishing Walmart MoneyCenters, Barnes and Noble cafés, and Apple Genius Bars where personal services and social meeting places are effectively intertwined with online personal and professional activities.

The current trend of credit unions adopting underwriting, mortgage modification, and debt collection policies that mirror the commercial bank sector makes it more difficult for credit unions to distinguish themselves and thus attract consumers who are seeking alternative service providers.

With the protracted recession fracturing the relationship of hundreds of thousands of families with commercial banks, and with the U.S. Congress, federal regulators, and mass media intensifying their criticism of commercial bank lending and collection and foreclosure policies, credit unions have had an extraordinary opportunity over the last two years to attract millions of new members while reengineering the credit union system to become more responsive to America's changing social and economic landscape. Indeed, by developing innovative credit union product bundles, new modes of credit union communications with members, improved credit union member retention over the life cycle (see Manning 2005 for these different credit needs), customized credit union branches for local member needs, and strategic credit union partnerships with community groups and retailers (such as successful auto dealer loan programs), credit unions have been able to highlight the personal connection with credit union members that underscores their "member first" mission. Nevertheless, if these efforts to bolster the credit union brand are only modestly successful, Walmart will be a major beneficiary of the current consumer backlash against the major commercial banks.

If efforts to bolster the credit union brand are only modestly successful, Walmart will be a major beneficiary of the current consumer backlash against the major commercial banks.

Not surprisingly, the new lifestyle dynamics of young adults are clashing with traditional credit union policies. This is mirrored in their critical assessment of basic services offered by credit unions as reported by Hofheimer (2008). The top reasons reported by young credit union members for not conducting more personal banking business (deposits, checking accounts, loans) with their credit unions primarily reflect their dissatisfaction with the physical location of branches, lack of ATMs, inconvenience of switching commercial bank accounts, more stringent credit union underwriting standards,

Figure 6: Reasons for Young Adult Dissatisfaction with SEG-Based Credit Union Services (2008)

Deposits	Checking	Loans
1. Inconvenient transaction location 2. Inconvenient ATM location/too few ATMs 3. Inconvenient office location	1. Inconvenient ATM location/too few ATMs 2. Inconvenient transaction location 3. Too difficult to switch	1. Inconvenient office location 2. Uncompetitive rates 3. Previously turned down at institution

Source: Hofheimer 2008.

and less competitive loan rates. Together, these sentiments underscore the growing vulnerability of credit unions to new nonbank service providers like Walmart.

The growing likelihood that credit union members will conduct more of their personal banking activities at Walmart and other nonbanks is consistent with the findings of the 2007 Financial Service Centers of America (FiSCA) survey. This study, which is representative of about 3,850 of 6,500 FiSCA member stores, found that 58% of the survey respondents reported having an active bank checking or savings account. Among this "banked" group, their main purposes for visiting financial service centers are instructive: cashing a check, followed by purchasing a money order and then paying bills or obtaining a payday loan. More intriguing are their primary reasons for using these nonbank services: convenience (location, ease of use, hours of operation), fast service, and friendly relations with employees (Crillo 2007). As previously discussed, young credit union members cite these same reasons for not conducting more business with their credit unions. See Figure 7 for the key reasons cited by respondents for going to a financial service center and why the respondents used specific services.

With the rapid increase of costly overdraft payment "protection" and related bank service fees, moreover, millions of consumers are fearful that unexpected household emergencies will result in even greater financial difficulties due to unsympathetic and even capricious consumer banking policies. This apprehension over unwelcoming

Figure 7: Primary Reasons for Using Basic Consumer Financial Services at Nonbanks (2007)

Main reason for going to the financial service center	1. Check cashing 2. Purchase money order 3. Bill payment/Payday loan		
	Check cashing	**Money orders**	**Money wire transfers**
Why do you use these services?	1. Need/like cash 2. To pay bills 3. Convenient location, hours, or ease of use	1. To pay bills 2. Fast service/like employees 3. Other	1. Send money to others 2. For family 3. Convenient location, hours, or ease of use

Source: Crillo 2007.

bank environments and escalating bank service fees constitutes an important backdrop in the successful marketing of prepaid payment cards and other credit/loan products by nonbank financial services providers. The Walmart MoneyCenter services are directly aimed at both banked and unbanked consumers whose personal and economic circumstances have discouraged their use of traditional bank services (Walmart 2009). But how important are these consumers to the future vitality of the credit union system? After all, they are not depositing savings or using credit/lending services. More importantly, where will these consumers conduct their banking business in the future when their household incomes increase over the family life cycle? Will they remain at Walmart and other nonbanks, or will they move on to commercial banks and credit unions? And what does it matter to the credit union system if Walmart cannot offer retail branch banking services? Is it possible that credit unions can become a key partner and fill this banking void in Walmart MoneyCenters for the foreseeable future? Ultimately, the key issue is whether Walmart's long-term business strategy will complement or compete with credit union banking services. A closer examination of the Walmart MoneyCenters offers some preliminary insights.

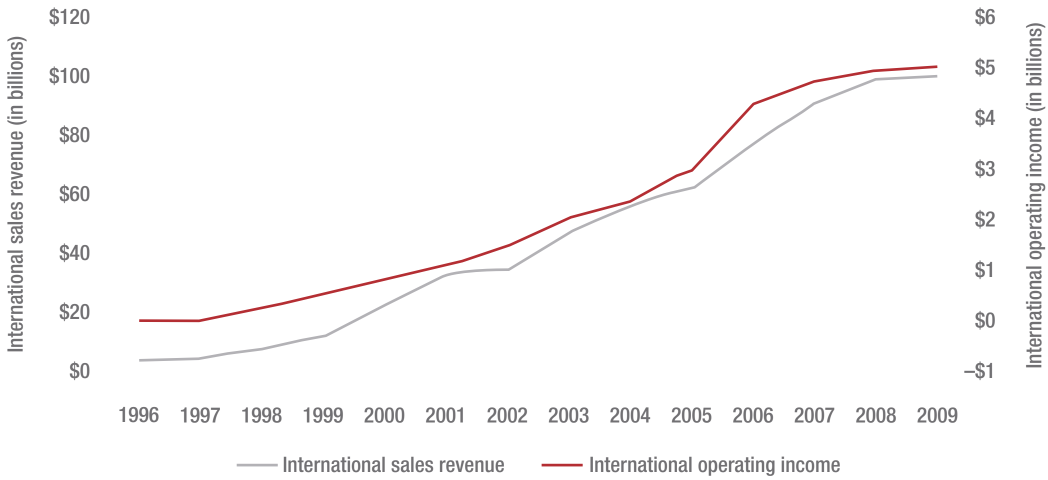
The Walmart MoneyCenter services are directly aimed at both banked and unbanked consumers whose personal and economic circumstances have discouraged their use of traditional bank services. But how important are these consumers to the future vitality of the credit union system?

Walmart MoneyCenters in the United States: Blending Banking with Retail Shopping

As Walmart approaches the limits of market growth in its core U.S. retail merchandise divisions, it has turned its attention to international markets, where it is experiencing mixed (with the potential of promising long-term) results. Over the last decade, the success of Walmart's global strategy has been uneven, although its aggregate growth is impressive. Between 1999 and 2009, international sales increased tenfold to $100B compared to U.S. sales that rose less than threefold to about $258B (Walmart 2010b). See Figure 8. The international consumer response to Walmart's expansion has ranged from hostile and uninterested (it is closing stores in Japan and Germany) to much more enthusiastic

By increasing its global business competencies to include consumer financial services, Walmart is developing its own retail banking expertise and corporate infrastructure for eventual expansion into the United States. The key issue is whether Walmart's long-term business strategy will complement or compete with credit union banking services.

Figure 8: Walmart's International Sales Revenue and Operating Income, 1996–2009



Source: U.S. Securities and Exchange Commission, *Edgar Online*. "Wal-Mart Stores SEC Filings (10-k annual reports), 1996–2010." www.sec.gov/edgar.shtml.

in countries such as Canada, China, and Mexico. More importantly, Walmart is pursuing a variety of legal and operational strategies for entering the consumer financial services markets in these countries. By increasing its global business competencies to include consumer financial services, Walmart is developing its own retail banking expertise and corporate infrastructure for eventual expansion into the United States. Like the enormous competitive advantages of its international warehousing and distribution networks, Walmart's ongoing development of its blended business model suggests that it is achieving formidable marketing/operational synergies that will add to its impressive global efficiencies of scale.

Over the last decade, Walmart has provided a wide range of consumer financial services in the United States. From check cashing, money transfers (MoneyGram), and bill payment services to debit cards and partnered co-branded credit cards (Discover and GE Money), Walmart offers its customers a wide array of transactional services that can be easily conducted during their regular shopping trips. Beginning with issuing money orders in 2000 followed by money transfers in 2003, Walmart provides its financial services through a national network of MoneyCenters, the first of which was inaugurated in September 2004. Walmart MoneyCenters are dedicated spaces inside its retail stores that "offer customers an inviting, safe and convenient place to handle their basic financial needs seven days a week" (Walmart 2010a). Currently, Walmart MoneyCenters primarily serve lower-income, high-transactional customers who tend to be neglected by commercial banks and even credit unions. But with the recession attracting more middle-income

Figure 9: A Walmart MoneyCenter

households and young consumers, Walmart is well positioned to broaden its market focus in the near future. According to Rosalind Brewer, executive vice-president and president of Walmart South, "Our customers love the convenience of one-stop shopping with money services at Walmart prices . . . Walmart MoneyCenters play a very important role in helping families save money so they can live better" (Walmart 2010a). Walmart estimates that in 2009 its customers saved approximately $450M in fees by using its financial services rather than those of national competitors (Walmart 2010a). Overall, Walmart operated about 450 MoneyCenters in 2008 and added another 300 in 2009 (Walmart 2009).

On March 16, 2010, Walmart celebrated the opening of its 1,000th Walmart MoneyCenter, in Chalmette, Louisiana.[3] At the grand opening, Jane Thompson, president of Walmart Financial Services, declared, "*Walmart MoneyCenters are a cornerstone of our business* and were specially created to give customers a welcoming environment where they can save when they cash checks, pay bills and transfer money . . . we are delighted to announce the expansion into approximately 500 more stores [in 2010]" (Walmart 2010a, emphasis added). This represents an astounding 50% growth over the previous year, which would place MoneyCenters in approximately 40% of all 3,763 Walmart stores nationwide.

Besides its growing front-end bundle of financial services, Walmart has improved its back-end operations by upgrading its payment processing technologies. Walmart can efficiently process check payments at the point of sale without back-office check conversion (BOC). The ability to scan a check's Magnetic Ink Character Recognition (MICR) and then return it to the customer provides a substantial cost savings for both its retail and financial services operations (Lucas 2007; Mann 2007). Indeed, this core transactional platform, developed for the retail sales division, can also process checks submitted from MoneyCenters. The synergy between Walmart's retail sales transactions and its financial services transactional volume is noteworthy. For instance, Aite Group estimates that Walmart customers account for nearly one-fifth (19%) of existing check-cashing customers. For consumers who regularly cash their paychecks, Walmart's market share has grown to 11%. Among these customers, 92% had shopped at Walmart over the previous three months (Aite Group 2009).

The magnitude of this transactional volume is impressive. For example, the FiSCA survey estimates that more than 137 million checks—with a total dollar value of over $56B—were cashed at its participating members' financial service centers in 2007. In addition, over 57 million bills were paid at these centers, generating over $57M in combined (payer and payee) fee revenue. And 2.8 million prepaid electronic payment cards were sold by these financial service centers in 2007. Overall, the FiSCA survey represents 59% of the 6,500 FiSCA member stores and approximately 30% of all financial service centers in 2007 (Crillo 2007). Hence, these reported transaction volumes constitute only about one-third of the national totals. In comparison, the recent growth of Walmart's MoneyCenters is staggering. At the end of 2008, according to Walmart's estimates, its MoneyCenters were processing over 2 million money orders, check cashing requests, and money transfers per week—a 40% increase from 2007 (Punch 2009). The volume of prepaid debit cards issued by Walmart in 2009 was almost double the number issued by all financial service centers in 2007 (Bills 2009). In 2009, Walmart processed over 3.5 million customer financial transactions weekly. By the end of 2010, with over twice as many MoneyCenters, Walmart could exceed 7 million financial transactions per week.

Figure 10: Examples of Walmart's Marketing Collateral

Walmart's MoneyCenter Network: The Soaring Demand for Consumer Financial Services

As previously explained, Walmart's future revenue growth targets are dependent upon the expansion of its international retail sales and consumer financial services divisions. In regard to the latter, Walmart is well positioned to attract millions of new customers to its national network of MoneyCenters. This is due to the huge population of 40 million un- and underbanked consumers (FDIC 2009), an increasing number of disaffected customers of commercial banks, and the rising volume of new Walmart shoppers during the recession. In the blended Walmart business model, the growth of banking customers contributes to higher merchandise sales, as many purchase other retail items during their visit to Walmart. Furthermore, Walmart's aggressive expansion into consumer financial services (over 60% compound annualized growth since its launch) is facilitated by the finance industry's high profits. For example, the profit margins of Walmart's traditional retail sales average 23.7% gross and 3.5% net (Walmart 2009), whereas the respective averages for comparable financial services companies range from 14% to 38% gross and 6% to 9% net (Crillo 2007; Bills 2009). Clearly, this symbiotic customer sales model has the potential to generate much greater Walmart Supercenter revenues by applying the same high-volume, lower-margin approach to consumer banking operations that has been so successful in its retail merchandise divisions. More intriguing, however, is the segmented business model that characterizes Walmart's financial services division in the United States and Mexico: high-volume, low-cost transactional services that serve as a loss leader for attracting more profitable consumer loans such as high-APR credit cards and refund anticipation loans (RALs).

Walmart's aggressive expansion into consumer financial services (over 60% compound annualized growth since its launch) is facilitated by the finance industry's high profits. For example, the profit margins of Walmart's traditional retail sales average 23.7% gross and 3.5% net, whereas the averages for comparable financial services companies range from 14% to 38% gross and 6% to 9% net.

Due to the FDIC's rejection of Walmart's application for an ILC charter and the continued opposition of Congress to a Walmart-owned bank in the United States, the consumer financial services available at MoneyCenters are provided directly by Walmart and indirectly via a wide range of retail banking partners. From money transfers to debit and credit cards to consumer loans and even investment accounts, Walmart offers its customers a full set of payment, credit, and investment account services that can be transacted during regular shopping trips. These payment and credit services are briefly summarized below.

Due to the FDIC's rejection of Walmart's application for an ILC charter and the continued opposition of Congress to a Walmart-owned bank in the United States, the consumer financial services available at MoneyCenters are provided directly by Walmart and indirectly via a wide range of retail banking partners.

Check Cashing

One of the first financial services offered by Walmart, check cashing is widely advertised in the national media as a low-cost service and is used to promote its MoneyCard, a prepaid debit card. Walmart will cash payroll or government checks, including tax-refund checks, starting at $3. Typically, Walmart charges 30% to 50% less than other check cashers, and the fee can be waived if the initial check is directly deposited into a MoneyCard. Additionally, if subsequent

Figure 11: Walmart Check Cashing Service Fee

Fee (government or payroll check)	$3.00

payroll checks or government checks are set up for direct deposit to the MoneyCard, then the check-cashing fee is waived, with the expectation that the customer will spend a substantial portion of the funds on Walmart retail goods and services. Hence, this check-cashing system essentially serves as a private-issue, prepaid payment card where most purchases debited from the MoneyCard will be captured by Walmart's retail operations. This illustrates how the Walmart blended model operates to increase total store revenues. That is, check-cashing fees serve as a loss leader to attract low-income and unbanked customers so that they will purchase more retail merchandise at Walmart.

Money Transfers

For many unbanked consumers, the ability to transfer funds to friends and family members is crucial to the economic survival of their families and extended households. This is especially important to migrant workers whose cross-border remittances constitute a $250B global market—including about $24B to Mexico. Through its MoneyGram system, Walmart charges approximately one-half the fee charged for similar services at Western Union and other money-wiring outlets. Consumers may transfer up to $200 per transaction at Walmart, which transmits the funds within minutes for a modest fee that starts at $7 plus applicable currency exchange fees. Walmart has contributed to a sharp decline in money transfer fees, which has significantly increased net remittances to Latin American countries—especially Mexico. This cost-effective transactional service illustrates how the blended business model attracts immigrant and unbanked customers while shaping their consumption and spending behavior during their visits to Walmart Supercenters. Significantly, in an effort to attract Latino immigrants, Bank of America has responded with a special program that offers three free money transfers per month for its customers with bank accounts.

Walmart has contributed to a sharp decline in money transfer fees, which has significantly increased net remittances to Latin American countries—especially Mexico.

Figure 12: Money Transfer Service Fees

Fees start at (excludes applicable currency exchange fees)	$7.00

Express Bill Payment Service

For unbanked consumers and those on the financial "edge" who are worried about generating costly overdraft fees due to insufficient funds and money management problems, Walmart offers an express bill payment service through its MoneyGram system. This payment

Figure 13: Express Bill Payment Service Fees

Standard three-business-day payment (via CheckFree)	$0.88
Next-day payment (via CheckFree)	$1.88
Same-day payment (via MoneyGram)—prices starting at:	$4.50
Money orders (via MoneyGram)	$0.60

Source: Walmart Stores. 2009. "Walmart MoneyCenter." www.walmart.com/cp/Wal-Mart-MoneyCenter/5433.

service, which includes issuing money orders, provides a convenient, secure, low-cost option for financially distressed and unbanked consumers. The fees for these services range from 60 cents for money orders and 88 cents for three-day electronic payments to $1.88 for next-day payments and $4.50 for same-day payments.

Walmart MoneyCard—Prepaid Debit Card

The Walmart MoneyCard is the flagship of Walmart's financial services armada. This "all-purpose," prepaid Visa debit card is easy to use and reasonably priced at $3 for consumers without a bank account and/or those seeking to control their spending and eliminate costly bank overdraft fees (Walmart 2009). First offered by Walmart on June 20, 2007, the MoneyCard essentially serves as an electronic checking account with consumer access to purchase and fee transaction account information as well as the ability to check current account balances. The MoneyCard is especially useful for customers who are typically paid in cash or who receive regular government checks. This is because the MoneyCard can "load" a specified amount of money—after cashing the check—for payment anywhere that uses the Visa debit payment platform. Hence, the MoneyCard provides consumers with the ability to link all of their Walmart financial services into a single transactional network with itemized payment account summaries.

As of August 2009, more than 2 million multiple-use MoneyCards had been purchased by Walmart customers. This represents a doubling from the previous year (Bills 2009). Like most prepaid cards, the MoneyCard does not require a credit check or a bank account and can be used on any Visa debit payment platform.

As of August 2009, more than 2 million multiple-use MoneyCards had been purchased by Walmart customers—a doubling from the previous year.

And, based on customer demand, an instant issue (temporary) debit card is included in the MoneyCard welcome package at sign-up. This is an important convenience for consumers without alternative payment options and who would otherwise have to wait for the permanent card to arrive in the mail. Not incidentally, the MoneyCard

Figure 14: Walmart MoneyCard Fees (2009)

Activation fee—Regular	$3.00
Activation fee—Student	$6.00
Monthly fee	$3.00
Add funds/reload—Check cashing (fee waived for government checks)	$3.00
Add funds/reload—Cash	$3.00
Add funds/reload—Green Dot MoneyPak	$4.95
Printed statement	—
Additional debit card	$3.00
Debit card replacement	$3.00
ATM withdrawal—in network	$2.00
Balance inquiry at ATM—in network	$1.00
International ATM withdrawal	$2.00
International ATM balance inquiry	$1.00

Source: Walmart Stores. 2009. "Walmart MoneyCenter." www.walmart.com/cp/Wal-Mart-MoneyCenter/5433.

can be reloaded with new deposits at Walmart MoneyCenters, by Walmart cashiers, and via Green Dot MoneyPaks available at Walmart, Walgreens, CVS, RiteAid, and many other retail outlets.

Walmart Credit Cards

Walmart offers two types of bank-issued credit cards through its partnerships with Discover and GE Money Bank. The first is an *open-loop* or *universal* Walmart Discover card that can be used to pay for merchandise purchased within the Walmart retail merchandise network as well as products and services purchased from other retailers through the Discover payment platform. In terms of creditworthiness, the client profile of the Walmart Discover card typically ranges from Alt A to low prime with interest rates from 13.9% to 29.9%; the average APR is 19.9% to 22.9%. The credit card, with a line of credit usually from $1,000 to $2,000, also offers balance transfers, cash advances, and cash reward rebates. The Walmart Discover card is issued by GE Money Bank.

If a customer is rejected for the universal Walmart Discover card, then the *closed-loop* or *proprietary* store credit card is recommended. Issued by GE Money Bank, the Walmart Credit Card offers a line of credit that typically ranges from $500 to $1,500 and can be used only for purchases within the Walmart retail network. The Walmart Credit Card *cannot* be used to purchase merchandise from retail competitors and does not offer balance transfers, cash advances, or cash reward rebates. The lower creditworthiness of these customers, ranging from subprime to Alt A, is reflected in the higher APRs: 22.9% to 29.9%. Note that these interest rates can rise with higher prime rates.

Figure 15: Walmart Credit Card APRs and Account Fees (2010)

Walmart Discover card (universal/open-loop)	
Introductory-period APR (first 6 months)	13.9%–29.9%
Late fee (over $249.99 balance)	$39.00
Overlimit fee	$25.00
Walmart Credit Card (closed-loop)	
APR	22.9%–29.9%
Late fee (over $249.99 balance)	$39.00
Overlimit fee	$25.00

Source: Walmart. 2010. "Walmart MoneyCenter." www.walmart.com/cp/Wal-Mart-MoneyCenter/5433.

Also, GE Money has recently introduced a universal credit card for small-business owners. Its terms are comparable to the Walmart Discover card and it offers discounts that appeal to self-employed and small-business proprietors.

All credit card accounts impose $39 penalty fees for outstanding balances over $249.99. Hence, Walmart benefits from the higher sales volume generated by its customers who receive these credit cards as well as lower interchange or merchant fees and other customer sign-up reward fees from these card-issuing banks. Not incidentally, in contrast with the brand image as the low-cost leader, the Walmart credit card APRs are considerably higher than the national average of 14%–15% in 2009 (Manning 2009). As will be discussed, risk-based pricing policies explain only a portion of the high cost of consumer loans at Walmart.

Walmart Easy Investing

Walmart Easy Investing ShareBuilder Accounts

As Walmart seeks to expand its array of financial services and attract a wider range of customers, it has partnered with ING Bank, FSB, to offer consumer investment services through its ShareBuilder Securities Corporation. These online investment account services are not affiliated with Walmart Financial Services or Wal-Mart Stores, Inc. Rather, Walmart is the virtual storefront for attracting new customers to ING Bank, which, in turn, offers a new financial service to Walmart customers in their quest for one-stop shopping at low-cost prices.

The ShareBuilder program is designed for new customers (there is a $25 bonus for opening a new account) as well as more experienced investors with its $4 stock trades and various investment support services. For the self-employed, small-business owners, and employees of companies without retirement investment accounts, the ShareBuilder program enables households to open IRAs for financial planning, including preparation for retirement. This complements partnered tax preparation services such as those offered by Jackson Hewitt in Walmart MoneyCenters. And, cognizant of the relatively low discretionary income of the Walmart customer base, the ShareBuilder program highlights its "no account minimum and no inactivity fees" while offering its customers the option of "investing any amount." For Walmart customers, this investment program reinforces the carefully nurtured image of Walmart MoneyCenter as the low-cost, full-service provider of all their financial needs.

Retail Banking Services: MoneyCenter Leased-Space Providers

At many MoneyCenters throughout the United States, Walmart is cultivating the expectation among its customers that "full-service" banking is available along with its traditional retail merchandise operations. These consumer branch banking services are provided by credit unions and regional banks that lease floor space from Walmart. One of the unintended outcomes of the MoneyCenter banking partnerships, however, is that these financial institutions may be planting the seeds for future competition that may be nearly impossible to challenge due to the advantages of Walmart's blended business model. That is, the convenience of combining consumer banking tasks with household shopping trips will be reinforced by the cost advantages of intertwining Walmart financial services with its retail merchandise operations. Hence, the growing smorgasbord of MoneyCenter services is priming the consumer pump for the eventual arrival of the Bank of Walmart in the United States.

One of the unintended outcomes of the MoneyCenter banking partnerships is that partner financial institutions may be planting the seeds for future competition that may be nearly impossible to challenge due to the advantages of Walmart's blended business model.

In the meantime, Walmart has forged a variety of bank partnerships that ostensibly are designed to better serve its lower-income customers who have poor credit histories and/or limited access to consumer credit. Particularly noteworthy, as illustrated by its relationship with CompuCredit, is that Walmart does not necessarily require cost-effective credit products—especially for its lower-income, subprime customers in minority communities. Indeed, the CompuCredit case illustrates Walmart's lack of concern over the high cost of these credit products, the high profit margins of these financial services, and potential market opportunities for credit unions. It also suggests that Walmart's fanatical commitment to low prices in its retail merchandise divisions may not be the primary business principle guiding its consumer financial services division. This is consistent with this report's preliminary findings in Mexico, where Walmart is not the lowest-cost leader in pricing its consumer credit products.

Walmart's business relationship with CompuCredit is instructive. CompuCredit has experienced a long history of consumer complaints, an enormous financial settlement with the Federal Trade Commission (FTC) in 2007 (over deceptive marketing and abusive collection practices),[4] and successive rejections by federal and state regulators in its quest to acquire a retail banking institution. As a result, like Walmart, CompuCredit has been forced to forge partnerships and joint ventures with other banks and bank holding companies. For instance, CompuCredit's efforts to expand into the African American urban consumer market led to a December 2006 partnership with Urban Trust Bank, a small savings institution with branches in the District of Columbia and Florida. Owned by Robert L. Johnson, the billionaire founder of the Black Entertainment Television (BET) network, the joint venture specified that Urban Trust Bank would issue Visa credit cards and CompuCredit would be responsible for marketing and servicing the consumer credit card program. The following month, Walmart announced an agreement with Urban Trust Bank to "bring affordable financial services to [underserved urban and minority] communities" (O'Hara 2006). Unfortunately for members of these underserved communities, the Urban Trust–CompuCredit "Salute" Visa credit card did not offer much financial relief in terms of new credit or competitive borrowing terms. The $70 credit line excluded a $20 account activation fee and a $19 monthly participation fee. The annual cost (12 months) of this $51 line of credit was $248. In comparison, the annual cost for a $50 payday loan is $182 (Jurgens and Wu 2007).

Other related consumer services include personal income tax filings prepared by Jackson Hewitt through leased satellite offices in over 1,200 Walmart stores. This illustrates Walmart's cross-marketing strategy that underlies its blended business model. For instance, Walmart.com features a customer being offered tax preparation services as well as a variety of products stocked at Walmart: hardware and software for preparing taxes (TurboTax, H&R Block software, PC bundles and other non–Jackson Hewitt branded products), organizing systems (file cabinets, security files/safes, file folders), and calculators. Although Walmart cannot directly provide consumer loans, Jackson Hewitt has offered costly RALs to its customers through its partnerships with Santa Barbara Bank & Trust (division of Pacific Capital Bank, N.A.) and Republic Bank & Trust Company, with effective interest rates ranging from 120% to over 300% APR when extra tax filing services are included (Jackson Hewitt, Inc. 2009).[5]

Cross-marketing may lead consumers to erroneously assume that Walmart is the low-cost leader in financial services—through its

MoneyCenters—based on the brand reputation of its retail division. The reality, however, is instructive. Walmart is riding the profitability wave of charging the financially distressed and underbanked the higher "fringe" bank rates rather than the much lower commercial bank rates. This was not the expectation of those touting Walmart's MoneyCenters for offering legally regulated and competitive branch banking services.

In sum, Walmart's current marketing strategy is to leverage its merchandise division's reputation as the industry's low-cost leader in the promotion of its *basic* retail banking services such as check cashing, money orders, and online bill payments. In this way, Walmart is reinforcing its corporate brand identity as the low-cost leader while attracting new customers to its MoneyCenters. Unlike credit unions, which must locate branches in strategic locations and invest in costly Internet-based technologies in order to acquire new or retain current members, Walmart's blended business model attracts new financial services customers through its existing retail operations. Many of these consumers, such as young workers and new immigrants, are not experienced with traditional banking services, have voluntarily abandoned traditional bank relationships due to employment and income interruptions, enjoy the convenience and familiarity of shopping at Walmart, or are seeking new bank relationships following stressful personal events such as bankruptcy, divorce, or medical difficulties. The result is a wide range of creditworthy consumers, many with few or unfavorable experiences with commercial banks, whose corporate loyalty underlies their decision to trust Walmart's declarations that it offers the lowest-cost consumer financial services.

Most Walmart customers, especially during this period of consumer credit scarcity, assume that the price structure of cheap transactional services will extend to more expensive loan products such as credit cards. For this diverse and price-conscious customer base, its frequently tainted experiences with commercial banks underlie its trust that Walmart is the low-cost leader in all of its product lines—including credit cards and RALs. Admittedly, Walmart customers include high-risk consumers as well as those with modest credit histories that justify risk-based loan pricing models with high finance rates and penalty fees.[6] Even so, the growth of the underbanked financial services system suggests that that competitive pricing dynamics are more likely to prevail *within rather than across* these parallel retail banking sectors. That is, many Walmart shoppers are more likely to understand and respond to the competitive dynamics of payday loans than the financial terms of credit cards issued by commercial banks. Furthermore, baseline cost comparisons of lending terms are more likely to include high-cost loans such as those from pawnshops as well as noneconomic factors such as convenience

(RALs) and customer respect (rent-to-own stores). Together with its blended business model, where consumer credit is extended for purchasing Walmart merchandise, Walmart's loan delinquencies/defaults are mitigated by profits from retail sales. Furthermore, the riskiest borrowers not only receive the highest finance rates but are limited to closed-loop credit cards that can only be used in Walmart retail stores.

As Walmart MoneyCenters evolve into high-volume, full-service consumer banking providers, the fundamental question remains: Whose customers are they serving? Are consumers attracted to MoneyCenters due to their convenient location within Walmart Supercenters, or due to personal business relationships with individual service providers? If Walmart replaced existing banks and credit unions with its own branded retail banking branches, would consumers continue to shop at Walmart for their financial services or would they conduct their financial affairs at a different bank or credit union branch location? This issue emerged in 2001 following Walmart's decision not to renew the satellite office leases of some banks and credit unions (Cocheo 2004). In view of Walmart's carefully cultivated reputation for low-cost products and its expanding offerings of consumer financial services, it seems more likely that the core Walmart customer base will continue to combine its banking activities with a trip to the Supercenter rather than conduct its financial affairs during a separate trip to the bank or credit union.

In view of Walmart's carefully cultivated reputation for low-cost products and its expanding offerings of consumer financial services, it seems likely that the core Walmart customer base will combine its banking activities with a trip to the Supercenter rather than conduct its financial affairs during a separate trip to the bank or credit union.

It is imperative that the credit union system increase public awareness of the key differences between banking cooperatives and commercial banks. If such a public awareness campaign is not successful, then financial services offered by credit unions may become indistinguishable from Walmart-partnered products and services where price and convenience will be the determining factors as shaped by the corporate Walmart brand.

Clearly, *now* is the time for proactive responses by credit unions to prepare for the inevitable arrival of the Bank of Walmart—before the establishment of its branch banking network throughout the United States. This business strategy, which is currently not permitted in the United States by federal regulators and Congress, will be discussed in the next chapter, which introduces the Mexican case study of Banco Walmart. Note that those retailers that have survived and prospered after the arrival of Walmart typically responded aggressively by diversifying their strongest product lines, developing effective advertising campaigns, and temporarily cutting prices. A confrontational strategy that includes direct competition with Walmart—by offering only the best-selling items at the lowest possible prices—has not proven to be successful (Ailawadi et al. 2010). As a result, it is imperative that the credit union system increase public awareness of the key differences between banking cooperatives and commercial banks. Encouraging consumers to think carefully about their banking choices is critical, since cultivating this brand awareness may take a considerable period of time. *If such a public awareness campaign is not successful, then financial services offered by credit unions may become indistinguishable from Walmart-partnered products and services where price and convenience will be the determining factors as shaped by the corporate Walmart brand.*

CHAPTER 4
Walmex: Walmart Goes to Mexico

Walmart's financial services model is uniquely suited to the Mexican market, where banks have historically focused almost exclusively on wealthy segments. A welcoming regulatory environment and better banking profit margins make Mexico an attractive testing ground for the company's financial services strategy.

On November 7, 2007, the promise of Every Day Low Prices (EDLP) finally arrived for Mexican banking customers in the industrial *municipio* of Toluca, outside of Mexico City. Walmart's historic entry into retail banking began inauspiciously as its first branch was opened in a nondescript working-class strip mall, next to a bakery store and a beauty parlor. By the end of 2007, Banco Walmart, a subsidiary of Walmart de México (Walmex), was operating 16 bank branches located within Walmex retail stores (Whelan 2008). Unlike in the United States, where a new Walmart often generates controversy over its low wages and negative impact on small businesses, Walmart's labor practices in Mexico are not worse than its competitors, and its low prices trump nationalist resentment over foreign business expansion. Furthermore, Walmart has adroitly exploited its relationships with Mexican suppliers by highly publicizing its role in promoting their exports throughout the world. And, with only about one out of five Mexicans possessing a bank account, the arrival of Banco Walmart was welcomed with open arms as the populist "David" seeking to help working-class Mexicans in their financial struggle against the elitist banking "Goliaths" like Citibank, HSBC, and Santander.

Walmart is swiftly implementing its blended business model in Mexico by directly offering Banco Walmart financial services within its retail stores as well as at its checkout counters. Without the opportunity to generate finance and other retail banking revenues, Walmex would be handicapped in achieving its retail expansion and merchandise revenue goals.

The objective of the National Banking Commission in approving bank charters for Walmart and four other companies in 2007 was to increase competition in the highly concentrated Mexican banking industry, which has historically neglected lower- and middle-income families. Indeed, Mexican consumer financial services are among the most costly and difficult to obtain in Latin America. Although Banco Walmart is not the low-cost leader in consumer lending, it has aggressively sought to improve access to banking services among underserved working-class households. Emphasizing that its financial services are "as easy [to use as] going to the supermarket" while fulfilling the EDLP tradition of providing "convenience, simplicity, and price" (Walmart de México 2009), Walmart is swiftly implementing its blended business model in Mexico by directly offering Banco Walmart financial services within its retail stores as well as at its checkout counters, where customers can pay bills and make savings deposits with Walmart cashiers. Only one year later, Banco Walmart had more than doubled its banking network to 38 branches (serving over 115,000 customers), jumping more than fourfold to 157 bank branches by September 2009 (Comisión Nacional Bancaria y de Valores 2009). This is a significant trend in a country where there are only eight bank branches for every 100,000 people (Juhn 2007).

Figure 16: Timeline of Banco Walmart in Mexico

- **1991** Walmart's first international expansion, joint venture with Cifra to open Sam's Club in Mexico City.
- **1997** Expansion into Mexico by acquiring majority position in Cifra.
- **2000** Cifra now known as Walmart de México.
- **2006** Walmart de México receives a license from Mexico's Finance Ministry to organize and operate a retail bank.
- **2007** Banco Walmart de México Adelante begins operations with 16 branches in 5 states.
- **2008** 38 Banco Walmart branches are now open, with checking, savings, closed-loop/in-store credit cards, and installment loans for in-store purchases.
- **2009** Banco Walmart offers open-loop credit cards.

For Mexicans working and living in the United States, the Walmart shopping and banking experience transcends political boundaries as this new bundle of consumer financial services becomes more commonplace on both sides of the border. Indeed, use of consumer credit such as bank-issued credit cards is a long-standing feature of the socioeconomic integration process of Mexican immigrants as they work and settle in the United States (Portes and Bach 1985). Furthermore, like rent-to-own outlets in the United States, it is now common for retail stores in Mexico to offer high-APR, installment-plan financing to middle- and lower-income Mexicans for purchasing in-store merchandise—ranging from low-priced appliances such as microwaves to costly durable goods like refrigerators and stoves to expensive items like automobiles.

The rapid evolution of this blended business model is crucial to Walmart's success in Mexico. This is because Banco Azteca, the bank subsidiary of Grupo Elektra that launched in October 2002, features an enormous retail banking network (1,179 branches in 2009) that includes the retail stores of Azteca—Walmex's much larger competitor (Comisión Nacional Bancaria y de Valores 2009). Without the opportunity to generate finance and other retail banking revenues, Walmex would be handicapped in achieving its retail expansion and merchandise revenue goals. In addition, Mexicans with existing relationships with Walmex feel comfortable shopping and conducting their banking activities at Walmart after coming to the United States. This is due to their favorable retail shopping experiences, familiarity with the company's policies, and Walmart's receptivity toward their patronage in the United States. Furthermore, Mexicans who have banking relationships with Walmart in the United States are more likely to use Walmex financial services when visiting friends and family in Mexico. Hence, the binational flow of Mexican workers, family, friends, and tourists will reinforce the cross-marketing synergies of the blended business model on both sides of the border.

Walmart's road to consumer banking in Mexico is integrally tied to its retail operations. Beginning in 1991, Walmart entered the Mexican retail market—its first international venture—when Walmart and Mexican retail giant Cifra formed a joint venture and opened the first Sam's Club in Mexico City. Two years later, the first Walmart Supercenter opened, and in 1994, the Suburbia and Vips retail units were formed. Walmart acquired majority control of the joint venture in 1997, and it was renamed Walmart de México (Walmex) in February 2000. Today, Walmart de México is already one of the largest retail chains in Mexico. At the end of 2009, operating under Walmart as well as other Mexican brands acquired through joint ventures and outright purchase, Walmex operated 1,477 units, including self-service stores, warehouse membership clubs, apparel stores, and restaurants. These Walmex retail stores are located in 245 cities throughout the 32 *estados* of Mexico.

Walmex Strategy: More Than Every Day Low Prices

At the end of 2008, Walmex CEO Eduardo Solórzano listed profitable growth, talent development, and social responsibility as Walmex's strategic priorities. Solórzano declared that Walmex was committed to major capital investments for continued market expansion and job creation while improving its supply and distribution networks in order to improve corporate efficiencies (Walmart de México 2009). Walmex's EDLP campaign enabled it to successfully compete with its domestic competitors as the global recession deepened in 2009. This is a testament to Walmart's carefully cultivated brand identity—as a global rather than American corporation—that has enabled Walmex to quickly overcome nationalist prejudices and preferences. In 2009, Walmex reported an impressive 15% increase in net income over 2008, or Mex$16.8B, which is approximately US$1.3B (Walmart de México 2010). The growing popularity of the Walmart retailing brand is strongly related to its effective marketing campaigns that directly link EDLP with the economic value provided to Mexican communities. Growing legions of Mexican consumers shop at Walmex stores with the conviction that Walmart's retail prices are lower than their competitors. Significantly, this assumption often is not true. For example, some of Walmart's retail competitors have created purchasing alliances that enable them to match and even offer lower prices than Walmex. Even so, the Walmex marketing campaigns have successfully forged a low-cost brand reputation in Mexico—as in the United States—that portrays retail competitors as unable to compete with Walmart's low prices (Bensinger 2005).

As a part of its corporate growth strategy, Walmex has been steadily opening new stores and commercial outlets in all of its different business formats. Figure 17 lists the six primary retail groups by number of retail units and proportion of corporate sales: Bodega Aurrera, Walmart, Sam's Club, Superama, Suburbia, and Vips. Not surprisingly, Walmart and Sam's Club stores account for only about one-fifth (18%) of the total Walmex retail empire of 1,477 units, while they account for over one-half (55.2%) of all Walmex sales in 2009. In comparison, Walmex's Bodega division, which is its domestic discount retail group, accounts for 46.6% of its total retail units but only 33.7% of Walmex's sales in 2009. However, the Bodega division opened 246 new outlets during the year that attenuates its aggregate sales performance. These include Bodega Express stores, Bodega Aurrera, and Mi Bodega Aurrera.

The other three retail groups are responsible for only 11.1% of total corporate revenues, but they focus on a different market segment: middle-class families. Superama grocery stores offer quality, convenience, and service in middle-income neighborhoods, while Suburbia offers fashionable apparel at budget prices in middle- and upper-income malls. Although Vips would appear to be an underperforming division, contributing only 2.4% of total Walmex revenues based on 24.8% of all Walmex retail units, it is a middle-class restaurant whose brand identity is service, quality food, and the social status of its customers. Hence, Walmex's multiple-format strategy allows

Figure 17: Walmex Retail Groups by Proportion of Sales and Number of Retail Units (2009)

Name	Retail focus and markets	Walmex sales	Number of units
Bodega Aurrera	Discount stores offering basic merchandise, food, and household items at the lowest prices. Consumer value: low price.	33.7%	689
Walmart	Hypermarkets providing the widest assortment of goods from groceries to apparel and general merchandise. Consumer value: Price and assortment.	28.2%	169
Sam's Club	Membership warehouse clubs that focus on businesses and consumers who seek the best possible prices. Consumer value: Volume discounts.	27.0%	98
Superama	Supermarket located in residential areas. Consumer value: Quality, convenience, and service.	5.1%	69
Suburbia	Apparel stores offering the most recent fashions for the entire family at the lowest possible prices. Consumer value: Fashion with the best combination of value, price, and quality.	3.6%	86
Vips	Leading sit-down restaurant chain in the restaurant-cafeteria middle-class market. Consumer value: Convenience, status, and quality.	2.4%	366

Source: Walmart de México 2010.

Figure 18: Distribution of Urban Mexican Households by Socioeconomic Level (SEL) in 2005 (2010 U.S. dollars)

SEL	Average distribution % (2005)	Family annual income ($US)	
		Minimum	Maximum
A/B	7.5	$79,560	—
C+	13.7	$32,760	$79,559
C	18.3	$10,858	$32,759
D+	33.5	$6,365	$10,857
D	18.2	$2,527	$6,364
E	9.0	$0	$2,526

Source: AMAI Advances: Distribution of Socioeconomic Levels in Urban Mexico (López Romo 2006).

Note: Exchange rate of Mex$12.80 = US$1 (January 27, 2010).

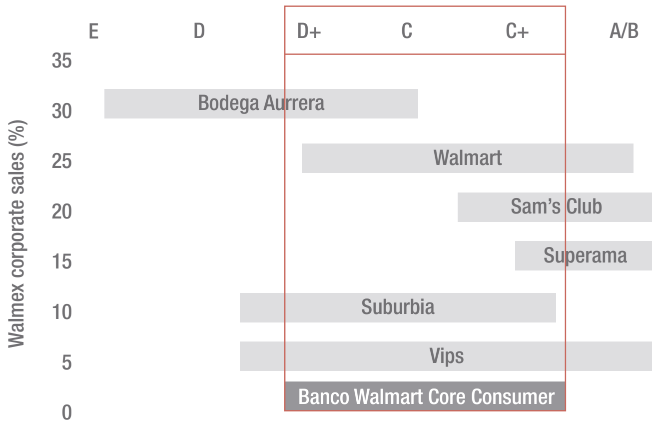
it to efficiently meet the needs of specific socioeconomic segments of the Mexican consumer market. See Figure 18 for the distribution of Mexican households by socioeconomic level in urban Mexican society in 2005 (López Romo 2006).

The annual median Mexican family income of less than $10,000 in 2005 (expressed in 2010 U.S. dollars) is surprisingly low considering the wage growth expectations of the North American Free Trade Agreement's (NAFTA's) free-trade policies. Indeed, the key assumption of NAFTA was that by reducing foreign capital investment restrictions in Mexico (IBM was the first wholly owned foreign subsidiary), the arrival of more technologically advanced plants and equipment (primarily from the United States and Japan) would increase labor productivity and reward Mexican workers with rising real wages that would narrow the 4–5 to 1 wage differential with the United States. By improving the buying power and standard of living of Mexican workers, NAFTA was expected to reduce internal pressures for migration to the United States and expand U.S.–Mexican trade, which would generate more jobs on both sides of the border. In addition, the growth of foreign direct investment would reduce Mexico's capital account deficit (i.e., reduce national borrowing demands); increase the national corporate tax base; strengthen the value of the peso, which would lower the inflation rate; and provide greater government resources for providing public services, jobs, and investment in key economic sectors. With rising household income and expanded employment opportunities, moreover, the extraordinary economic dynamism of the Mexican "informal" economic sectors was forecast to accelerate the rapid expansion of the domestic service sector (Manning and Butera 2000). Hence, NAFTA primarily was about attracting direct foreign investment, generating jobs, and increasing wages in Mexico. Consumer credit was viewed as an entitlement of the relatively small Mexican middle and upper-middle classes, and therefore its economic stimulative effect was viewed as limited to big-ticket purchases such as homes and automobiles.

Unfortunately, NAFTA has largely failed to achieve even its modest goals in Mexico. With the youthful Mexican age structure and the higher education of women intensifying the demand for employment, job creation has been disappointing. This difficult situation has been exacerbated by the relocation of many manufacturing companies to Asia—especially China and Vietnam. Furthermore, cheap U.S. farm imports—particularly corn—accelerated the collapse of small-holder agriculture (including collectively owned *ejidos*) and exacerbated rural migration pressures to the United States. As a result, Mexican wage growth has registered little relative improvement in comparison to the United States. In fact, median income gains are relatively similar across both countries during the 1994–2006 period—belying the key assumption of NAFTA. This modest wage growth in Mexico has stymied the demand for U.S. imports as well as overall household demand following the end of currency stabilization that subsidized middle-class imports. And the scarcity of business capital contributed to the collapse of tens of thousands of new Mexican commercial enterprises during the financial crises of 1995, 2001, and 2005 as small businesses received little assistance from the banking or public sectors. As the failure of NAFTA led to a second-stage exodus of U.S. manufacturing to Asia, especially China, the stagnation in aggregate Mexican buying power (partially due to greater competition with China) led to an increased national dependence on Mexican worker remittances from the United States as well as the growing importance of consumer credit in maintaining consumption demand among working and middle-class Mexicans.[7]

Figure 19 presents the distribution of Walmex sales by corporate retail group and the income levels of its primary customer segments. For example, the Bodega division targets the lowest socioeconomic-level households (segments E, D, D+ and C–), ranging from an annual family income of less than US$2,500 to nearly US$11,000. Together, these stores were responsible for over one-third (33.7%) of all Walmex revenues while accounting for about two-thirds of all Mexican households. Suburbia's primary market segments are somewhat higher (D, D+, C, C+), with an annual household income that ranges from US$4,446 to over US$40,000. Suburbia contributes about 3.6% of Walmex revenues. Walmart's market segments span the widest range of socioeconomic levels (D+, C, C+, A/B), ranging from household incomes of US$6,300 to over US$80,000. Walmart accounts for 28.2% of Walmex sales. In comparison, Sam's Club (C, C+, A/B) with 27% total sales, Superama (C+, A/B) with 5.1%, and Vips (D+, C, C+, A/B) with 2.4% focus on the highest-income households. Even so, the majority of Walmex

Figure 19: Distribution of Walmex Corporate Sales by Retail Group and Socioeconomic Level of Primary Customer Segments (2008)



Source: Walmart de México 2009.

customers earn less than the median Mexican urban household income, which is consistent with the core Walmart base in the United States. Together with Walmex's market penetration in middle- and even upper-middle-income households, it is clear that Banco Walmart's growing customer base reflects household income and financial stress trends that are similar to those in the United States: struggling working-class and middle-income families.[8]

The ongoing development of Walmart's blended business model is revealed in the current retail patterns and market dynamics of its core customers. In 2007, for example, Walmex began building Bodega Express shops. These modest-sized stores are comprised of only 4,300 square feet of retail space and are designed to compete with the small shops that dominate low-income neighborhoods. Through these Express stores, Walmex offers smaller packages of retail products, like single-use servings of cereal, milk, and tortillas. This product line enables Walmex to respond to the financial needs of Mexicans who purchase their groceries on a daily basis and even meal-to-meal. Due to the ongoing recession, moreover, this market segment of low-income Mexicans is growing. According to World Bank forecasts, the number of Mexicans living in poverty increased by more than 4 million in 2009. The daily minimum wage is Mex$55.85, or US$4.35, per day (Schmall 2009). By offering smaller retail package sizes, Walmex encourages smaller transactions while promoting more frequent customer visits. In the process, the higher volume of Bodega store visits creates multiple opportunities for Banco Walmart to cross-sell its products and services. Indeed, it is expected that many customers attracted to Walmex based on low retail prices and frequent visits will opt to conduct their banking activities at a Banco Walmart branch rather than making an additional trip to another bank branch. Furthermore, this transactional pattern provides a unique opportunity for Banco Walmart to attract new customers through its "save the change" program, whereby customers who pay with cash can open a saving account with Banco Walmart and automatically deposit their change, which can be used to buy other

It is expected that many customers attracted to Walmex based on low retail prices and frequent visits will opt to conduct their banking activities at a Banco Walmart branch rather than making an additional trip to another bank branch.

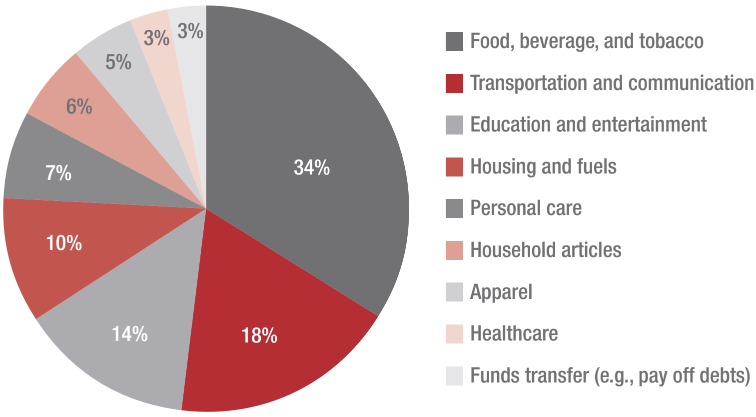
Walmart products in the future. As a result, Banco Walmart can influence the banking behaviors of Walmex's un- and underbanked customers by seamlessly integrating their daily shopping routines into the blended business model of Walmart.

With the growth of its multiformat retail platform, Walmex is not only increasing its market share in Mexico by attracting more customers, it is also expanding its share of household purchases by existing customers. That is, the proportion of each customer's total household spending (products and services) in the Walmex retail network is increasing. Unlike American families, which typically spend 30%–45% of their household budget exclusively on housing-related expenses, Mexican families only allocate about 10% to housing while they spend about 45% of their income on food, beverages, tobacco, household articles, and apparel, as shown in Figure 20 (Instituto Nacional de Estadística y Geografía 2009).

Walmex can potentially transact nearly 60% of the average Mexican family's monthly retail purchases. With their convenience and low-price reputation, Walmex stores are becoming one-stop shopping destinations. It will not be difficult to persuade many of these customers to conduct their banking activities at a Banco Walmart branch.

In addition, Walmex customers can make payments for other expenditures through the Walmex payment system. For example, at a Bodega Aurrera cash register, customers can pay their utility bills ("housing and fuels" category) and their automobile license plate fee ("funds transfer" category). Together with purchases for education and entertainment such as books or DVDs, communication such as

Figure 20: Distribution of Mexican Household Expenses (2008)



Source: Instituto Nacional de Estadística y Geografía 2009.

cell phones or prepaid calling cards, and personal care such as cosmetics and nutritional supplements, Walmex can potentially transact nearly 60% of the average Mexican family's monthly retail purchases. Consequently, this reputation for convenience and low price is contributing to Walmex stores becoming a one-stop shopping destination. It will not be difficult to persuade many of these customers to conduct their banking activities at a Banco Walmart branch.

The Post–World War II Mexican Banking Industry: Rapid Change and Concentration

The Mexican banking system has a long history of institutional dysfunctionality that underlies the present crisis in commercial and consumer lending (McCaleb 2009; Sigmond 2008; Haber 2005a). This is due to regional conflict among economic elites that undermined the development of a stable financial environment, political instability such as civil wars that impeded nation-state building and establishment of a strong federal bank network, scarcity of capital arising from undeveloped domestic industry and limited international investment/trade, frequent national expropriation of private banks to fund insolvent political regimes, lack of effective federal regulatory oversight to encourage prudent bank lending, a highly concentrated banking system with interrelated conglomerate directorates, a crisis in public and international confidence due to the recent collapse of the national monetary system, and ambiguously defined private property rights that have increased the difficulty of enforcing commercial contracts such as debt collection and thus increased the risk of lending, especially to new groups of borrowers.

Not surprisingly, the contemporary national banking system has been a major impediment to Mexican economic modernization policies. Indeed, one of the striking features of Mexico's integration into the western hemisphere's free-trade regime, whether marked by entry into the General Agreement on Trade and Tariffs (GATT) in 1986 or the enactment of NAFTA in 1994, is its consistently low rate of economic growth—about 1% per year *before* the 2007 recession—as measured in real per-capita gross domestic product (GDP) (International Monetary Fund 2009). This anemic performance is even more astounding considering the enormous volume of foreign direct investment by Asia and North America during this period—especially the United States and Japan (Jordaan 2009).

One of the key contributing factors is the lack of available commercial and consumer credit (Tornell, Westermann, and Martínez 2003). Not only is Mexico's banking system extremely small, but historically it has allocated less than one-third of its assets to lending for private purposes (Haber 2005b). Overall, the ratio of private bank credit to firms and households to GDP in Mexico has been the lowest of any Organisation for Economic Co-operation and Development (OECD) country—and by a large margin; Mexico allocated about one-fourth of the rate of Canada, about one-third of the rate of the United States, and almost one-half the rate of Poland through the early 2000s. Even by Latin American standards, Mexico's ratio of private credit to GDP has been exceptionally low. It ranked below Nicaragua, Ecuador, Peru, Colombia, and even Guatemala in the early 2000s (International Monetary Fund 2009; Haber 2005a).

Not only is Mexico's banking system extremely small, but historically it has allocated less than one-third of its assets to lending for private purposes. Overall, the ratio of private bank credit to firms and households to GDP in Mexico has been the lowest of any Organisation for Economic Co-operation and Development (OECD) country—and by a large margin.

The sharp fluctuations and recent contraction in Mexican consumer lending are revealed by a comparison with post–World War II trends. Between 1939 and 1969, total lending to the private sector soared from only 6% to about 36%. According to Haber (2005a), its dramatic decline to nearly 10% of GDP in 1974 (maintaining this paltry rate through the early 1980s) was a consequence of Mexico's authoritarian political system—dominated by the Partido Revolucionario Institucional (PRI) since 1929—which routinely engaged in "de facto expropriation" of the private banking system in order to finance its unsustainable budget deficits.[9] For example, in the early 1980s, the Mexican banking system was nationalized as one of several economic policies that were enacted to address the nation's financial crisis. This resulted in the consolidation of the existing 32 credit companies into 12 commercial banks. A few years later, Mexico's Ministry of Finance (Secretaría de Hacienda y Crédito Público) enacted a massive restructuring of the financial system that sought wider regional expansion of the credit network and was accompanied by standardized prudential regulatory and lending policies. This time, the 29-bank system was consolidated and restructured into 18 credit institutions according to their operations in national, multiregional, and regional markets.

In 1991, the Mexican banking industry began the process of re-privatizing its 18 banks—with the top four controlling 70% of total Mexican bank assets. Significantly, the Mexican government did *not* attempt to foster greater market competition by breaking up the largest banks into smaller, competitive operational units. This decision maintained the existing status quo of high industry concentration and ensured more costly financial services to Mexican consumers.

On the one hand, these banking reforms released private banks from their obligation to finance the public sector debt following the 1986 financial crisis. Other new policies established by this reform legislation included the deregulation of interest rates for assets and liabilities products as well as the end of high capital reserve requirements. On the other hand, these new laws featured a set of market regulations for financial groups and reforms to the Credit Institutions' Law that provided greater regulatory oversight while improving access to consumer credit and strengthening private contracts.

Not incidentally, foreign banks were not permitted to participate in the 1991–1992 auctions of state-run banking institutions. By relaxing new bank reserve requirements and prudential lending rules as well as approving questionable financial transactions (heavy borrowing and little private investment capital from buyers, inflated bank asset valuations from bidders), the Mexican government received premium sale prices for combating the massive federal deficit while assuring Mexican bankers that they were acquiring politically secure oligopolies that could set high prices for their services. Ultimately, the new Mexican banking system emerged undercapitalized and heavily concentrated with especially high fees and interest rates that only higher-income households could afford.

After the privatization process, Mexico experienced an extraordinary expansion in bank lending. Between December 1991 and December 1994, total real bank lending doubled while housing loans nearly tripled.[10] This rapid increase in Mexican bank lending was not financed by the growth in bank deposits. Rather, loans exceeded demand deposits by roughly 20% from 1993 to 1995, with the difference funded by interbank lending, largely from foreign banks in foreign currency (Mackey 1999). Significantly, NAFTA of 1993 initially imposed stringent restrictions on foreign banks' operations in Mexico, including a limit of 30% in stock participation. The concern of the Mexican government was that foreign banks could eventually dominate and exploit the oligopolistic structure of the Mexican banking industry by charging even higher prices and tightening access to commercial and consumer credit. Note that the NAFTA agreement on financial services did not address concerns over Mexican banks or subsidiaries of Mexican-chartered banks that might seek entry into the U.S. consumer financial services market with the explicit goal of exploiting potential weaknesses in U.S. banking regulations.

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The bold and risky experiments in Mexican economic modernization and particularly bank privatization, as pursued by President Carlos Salinas de Gortari (1988–1994), collapsed only one year after the signing of NAFTA. In January 1995, Mexico was at risk of defaulting on its mounting foreign debts, as the burgeoning public deficit limited its range of financial options to more foreign loans,[11] increased foreign investment, greater petroleum revenues, more remittances from workers in the United States, increased tourism revenues, higher illicit drug revenues, and devaluation of the peso. Ultimately, a combination of all of these financial options was used by newly installed President Ernesto Zedillo (1994–2000) in managing the Mexican financial crisis (preceded by hyper inflation rates) that precipitated the dramatic devaluation of the peso in early 1995. International capital flight and shortages of domestic credit undermined the stability of the Mexican banking system as demand deposits were withdrawn amid panicked efforts to seek dollar-denominated investment vehicles. In the process, the so-called "Tequila Crisis" of 2005 resulted in the massive write-off of more than one-half of the asset value of the Mexican banking industry (Lee 2003).

Not surprisingly, domestic and international confidence in the Mexican economy and especially the Mexican banking system plummeted. Loan defaults soared with nominal interest rates exceeding 100%, while loan delinquencies jumped 156% in 1995, representing an astounding 15% of Mexican bank loan portfolios (Asociación de Bancos de México 2010). The undercapitalized Mexican banking system contracted sharply as the national budget crisis expanded into a more generalized financial crisis with intensifying domestic monetary, external debt, and systemic liquidity problems. This is reflected in the dramatic decline in bank lending to private borrowers—falling from 20% of Mexican GDP in 1991to 12% in 1994, a shockingly low level even by Mexican banking standards (Comisión Nacional Bancaria y de Valores 2009). As a result, the Mexican economy in general and the Mexican banking system in particular were desperate to raise new capital, which led to an abrupt shift in foreign ownership rules in the mid-1990s.

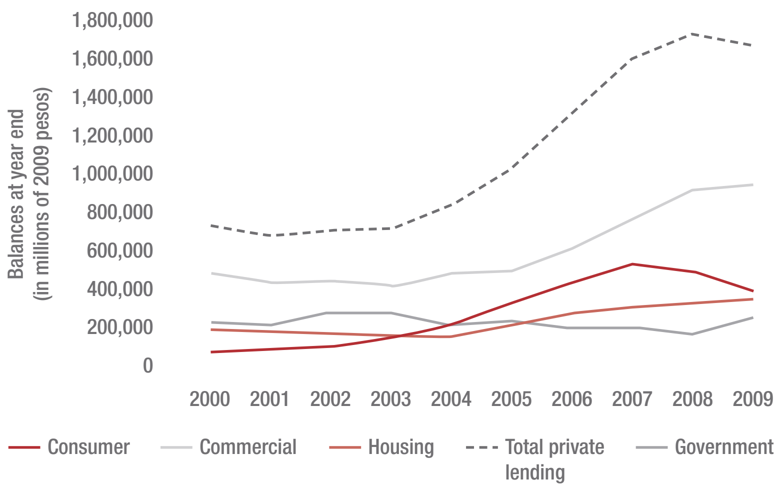
Mexican Financial Crisis of 2005: Industry Concentration and the Rise of Foreign-Owned Banks

In February 1995, restrictions on foreign bank acquisitions of Mexican financial institutions were eased, with permission to purchase Mexican banks with market shares of 6% or less. The following year, 1996, all foreign bank ownership restrictions were rescinded, which permitted the purchase of controlling interests in Mexico's largest banks. In December 1996 (just prior to the new rules regarding foreign ownership), only 7% of total bank assets in Mexico were controlled by foreign banks. And, about one-half were in free-standing investment banks or *foreign de novo* banks, which did not engage in retail consumer lending. By December 1999, 20% of bank assets were controlled by foreign banks, and by December 2004 the share of Mexican bank assets under foreign control had increased to 83% (Haber 2005a). This process of bank denationalization was accompanied by an open-ended bank bail-out program (1994–2001) that featured the Mexican government's purchase of underperforming "toxic" bank loans and essentially converting them to FOBAPROA bonds.[12]

Today, the Mexican banking industry is dominated by four large banks: Banco Bilbao Vizcaya Argentaria (BBVA) Bancomer (founded in Spain) with 1,838 bank branches; Banamex with 1,590 branches (a subsidiary of Citigroup); Hongkong and Shanghai Banking Corporation (HSBC) with 1,190 branches (headquartered in the United Kingdom); and Banco Santander (founded in Spain) with 1,054 branches. The banks controlled by Citibank, BBVA, Santander, and HSBC are among the six largest banks in Mexico. Together, they control over 80% of total assets of the Mexican banking system (Comisión Nacional Bancaria y de Valores 2009). The most notable difference after the relaxation of the foreign-ownership restrictions on Mexican banks was the surge in commercial and consumer lending during the bubble period (2002–2007), especially in consumer loans, along with the decline in lending to the Mexican national government.[13] For instance, government loans accounted for only 48.3% of the total Mex$1.4 trillion of loans in 2000; this fell to 15.9% of nearly Mex$2 trillion in 2009 (expressed in 2009 pesos). This reflects the end of the FOBAPROA bond bank bailout program, smaller government deficits, and greater external borrowing (Comisión Nacional Bancaria y de Valores 2009).

As expressed in 2009 pesos in Figure 21, the unrestricted entrance of foreign banks has successfully achieved the goal of injecting desperately needed capital into the Mexican economy. Between 2000 and 2009, private lending more than doubled (129%)—from Mex$723B to Mex$1.7 trillion—although it declined 3.1% in 2009. During this period, the proportion of private lending to total lending rose sharply from 51.7% to 84.1%. This represents a substantial improvement in bank lending for private purposes. Even so, when compared to total GDP, private lending in 2009 (based on the 4% contraction of the Mexican economy in 2008) is only about 11%, which is below the 2004 level of 12% and dramatically lower than the level of 20% in 1997 when Mexico opened its banking industry to foreign ownership (Haber 2005a). Commercial lending experienced the largest boost (from Mex$470B to Mex$935B) and even expanded during the 2007 recession, increasing 17.9% over the following two years. In

Figure 21: Private Lending in Mexico by Consumer, Commercial, Housing, Government, and Total Lending (2000–2009)



Source: Comisión Nacional Bancaria y de Valores 2009.

comparison to the United States, housing loans witnessed much more modest growth of 72.1% over the decade, from Mex$193.7B in 2000 to Mex$333.3B in 2009 (Comisión Nacional Bancaria y de Valores 2009); during this period, U.S. mortgage debt skyrocketed from US$4.7 trillion to US$10.2 trillion (Manning and Hofheimer 2009).

Interestingly, home mortgages in Mexico have grown steadily (10.3%) over the last two years of the recession (2007–2009), whereas they have declined modestly in the United States. In contrast, consumer lending in Mexico has experienced an extraordinary boom-bust cycle during this period. Between 2000 and 2007, consumer loans exploded nearly tenfold from only Mex$59.9B to Mex$519.5B. Clearly, access to consumer credit helped to fuel domestic consumption while Mexico coped with the disappointing economic outcomes of NAFTA (Manning and Butera 2000). With the onset of the 2007 recession, however, foreign banks abruptly turned off the consumer credit spigot. Consumer lending fell sharply (–25.4%) over the next two years to Mex$387.4B compared to an average annual growth rate of over 100% during the 2000–2007 period (Comisión Nacional Bancaria y de Valores 2009). See Figure 46 in the appendix.

When Walmart and four other new retail banks were approved to operate in Mexico, less than one out of four Mexican households had a bank account; low-income families were especially ill-served.

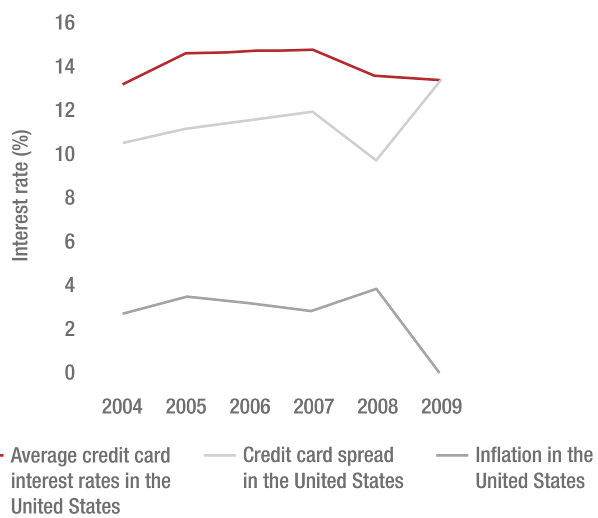
What is striking about the contemporary Mexican banking system is that rapid privatization and denationalization, together with Mexico's embrace of the free-trade regime under NAFTA, have *not* fostered a competitive consumer lending market that has substantially reduced prices or increased access to consumer credit; the top six Mexican banks have pursued a low-risk, fee-based consumer lending model that charges among the highest finance rates and fees in all of Latin America. According to Oscar Levin Coppel, director of the Mexican government agency responsible for the financial protection of consumers, Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros (CONDUSEF), fees for checking accounts as well as credit and debit withdrawals are "significantly higher" in Mexico than in other Latin American countries. Based on a 15-month study published by CONDUSEF in September 2004, Levin Coppel declared, "The leading banks are fixing the level of fees . . . This is called collusion. The presence of foreign capital has not translated into a reduction in the cost of various services and products [in the Mexican banking sector]" (quoted in SourceMex 2005). Levin Coppel explained that 45% of bank earnings were derived from charging exorbitant fees on consumer financial services. Significantly, BBVA-Bancomer and Banamex-Citibank, the two largest Mexican retail banks and presumably among the most efficient, charged the highest fees.

To the chagrin of Mexican consumers, foreign-owned banks sharply reduced consumer loans during the 2007 recession and thus contributed to Mexico's historically low levels of consumer credit per capita—among the worst in Latin America (Haber 2005a, 2005b). In 2007, when Walmart and four other new retail banks were approved to operate in Mexico, less than one out of four Mexican households had a bank account—especially low-income families (Malkin 2006; Juhn 2007). This compares with over one-half of Chilean families (Whelan 2008). In view of the ongoing failure of NAFTA to generate sufficient jobs and higher real wages for the rapidly growing Mexican workforce, Mexican policymakers realized that the growth of the domestic consumer market and thus greater access to consumer credit were both an economic *and* political priority. Unfortunately, these foreign-owned banks have behaved more like oligopolists rather than market innovators by emulating the traditional risk-averse behavior of Mexican banks as shaped by two centuries of costly expropriation policies.

Mexican banks, maintaining their traditional focus on middle- and upper-income households with extensive credit histories and existing bank relationships, have been reluctant to expand into creditworthy market segments of lower-income groups that do not have traditional bank accounts. This policy is partially due to these foreign banks' traditional dependence on more detailed and accurate consumer histories in their home countries (as routinely requested from credit reporting bureaus) as well as the higher risk of loan losses due to ambiguous private property rights and debt collection laws that prolong the asset recovery process and therefore increase the cost of lending. Together, these factors explain the much lower lending levels for private purposes (businesses and consumers) by foreign-owned banks in Mexico as well as the high cost of consumer loans—at the top of the price structure in Latin America. After all, why should the largest banks assume much greater risk by entering into new and lower-income consumer markets when the existing profit margins on middle- and upper-income customers are so high?

The high profit margins of retail banking operations in Mexico are illustrated by comparing the price structure of credit cards in the United States over the last five years. As shown in Figure 22, U.S. inflation ranged from 3% in 2004 to 4% in 2008 while unsecured, revolving credit card APRs consistently averaged 13%–15% (U.S. Federal Reserve Board 2010); real U.S. credit card interest rates, or the spread between nominal finance rates and inflation, soared in 2009 following the enactment of new federal credit card regulations (PEW Health Group 2009). The credit card interest rate spread, or difference between nominal interest rates and inflation, peaked at 12% in 2007 and dropped to about 10% in 2008. By U.S. historical standards, this is a very high interest rate spread for credit cards. Together with record fees and relatively low default rates, the American credit card industry enjoyed record profits during this period (Manning 2009; U.S. Federal Reserve 2009).

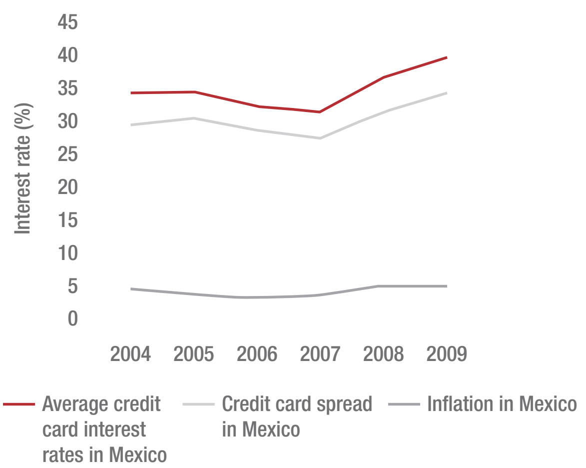
Figure 22: U.S. Credit Card Interest Rates, Credit Card Interest Rate Spread, and Inflation: 2004–2009



Sources: U.S. Federal Reserve System, Federal Reserve Statistical Release, Table H.15 Selected Interest Rates (2010). Available at www.federalreserve.gov/releases/h15/current/h15.htm; U.S. Department of Labor, Bureau of Labor Statistics 2010.

Figure 23 illustrates the much higher cost of credit for Mexican consumers—especially in comparison to the United States. By historical standards, the inflation rate in Mexico has been incredibly low at approximately 5% over 2004–2008, only about 2 percentage points higher than the United States during this five-year period. Unsecured, revolving credit card APRs averaged about 35% in the mid-2000s, dipped to nearly 32% in 2007, and have jumped to nearly 40% today (Banco de México 2009). Strikingly, the Mexican credit card interest rate spread was 30% in the mid-2000s, fell modestly to almost 28% in 2007, and has climbed to nearly 35% today. By U.S. standards,

Figure 23: Mexican Credit Card Interest Rates, Credit Card Interest Rate Spread, and Inflation: 2004–2009



Source: Banco de México. CPI Consumer Price Index Table. Available at www.banxico.org.mx/sitioingles/PortalesEspecializados/inflacion/indicators.html.

even during the golden era of the mid-2000s, this interest rate spread is extraordinarily high. It underscores why major global banks like Citibank cite their retail banking operations in "emerging markets" like Mexico as a key source of present and future corporate profits (Gerspach 2010). For instance, Grupo Financiero Banamex SA, the Mexican unit of Citigroup, Inc., contributed 11% to its parent's total sales in 2008 after doubling profits over the preceding six years (Arrioja and Rota 2009). It also shows how the global recession is dampening the pace of economic recovery for major U.S. commercial banks (and increasing the scale of taxpayer subsidies) since their foreign subsidiaries are not contributing their previously impressive rates of return on assets (ROA).

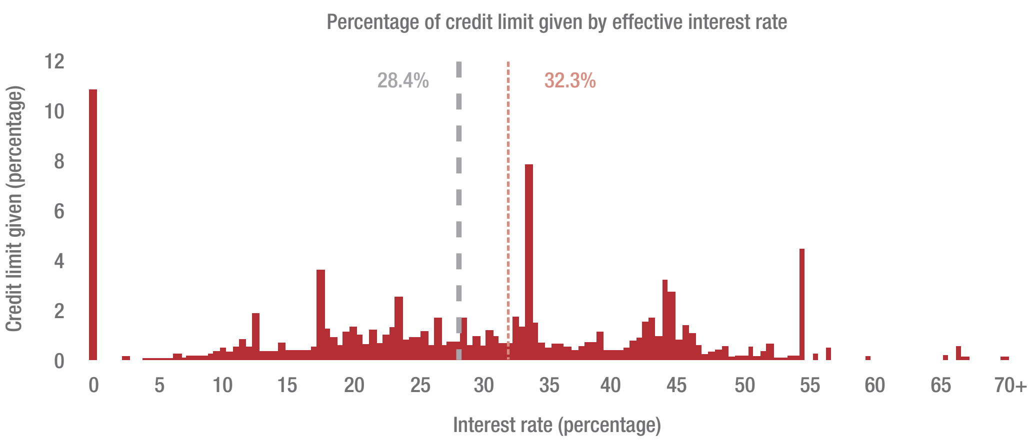
The much more costly consumer lending prices in Mexico are documented by the 2004 CONDUSEF study. According to CONDUSEF Director Levin Coppel, the major Mexican banks, which are all foreign-owned, charge much higher fees in Mexico than in their country of origin. For example, a credit card issued by HSBC in Mexico featured an APR of 77% compared with 16% for a comparable card in England. Similarly, a Scotiabank credit card had an APR of 77% in Mexico versus 18% in Canada. The cost differential was even greater for Banamex-Citibank credit cards: A Mexican card had an APR of 85% compared with 9% in the United States (SourceMex 2005). Even affluent Mexicans are experiencing these high borrowing rates. The Mexico City daily newspaper *La Jornada* (2005) reported the following credit card programs for wealthier consumers: Citibank Classic (39.6%), the Banamex Clasica MasterCard (39%), the American Express Bank (38%), the Scotia Clasica MasterCard (37.96%), the Santander Clasica Visa (37.15%), and the Bital Clasica MasterCard (34.9%). And private-issue retail credit cards usually feature higher APRs than bank-issued credit cards. This includes higher-end retailers like Palacio de Hierro and Puerto de Liverpool, which are competing with retail banks in the credit card market for these affluent customers (SourceMex 2005).

> The Mexican credit card interest rate spread was 30% in the mid-2000s, fell modestly to almost 28% in 2007, and has climbed to nearly 35% today. By U.S. standards, even during the golden era of the mid-2000s, this interest rate spread is extraordinarily high.

At the end of 2009, according to Banco de México (2009), the *median* credit card APR in Mexico was 32.9%, ranging from a low of 24% to a high of 67%.[14] This is more than twice the comparable interest rates in the United States and is even higher in risk-assessed terms, since the Mexican credit card market includes a very small proportion of low-income households. As presented in Figure 24, the rank order of the most common credit card APRs in Mexico is: 0% teaser rates, 34%, 43%, 18%, and 55%. If the subgroup of short-term 0% interest rates is excluded, the median APR is more than 37% (Banco de México 2009).[15] With Mexicans desperate for greater access to credit at more reasonable prices, it is no surprise that Banco Walmart was initially viewed as a savior, with the expectation of high customer volume driving down operating costs and consumer credit prices. Indeed, in its approval of a bank charter for Walmart, the National Banking Commission of Mexico assumed that Banco Walmart would import its aggressive cost reduction and marketing strategies from the United States and apply them to Mexican consumer financial services. In the process, the explicit goals were to increase competition in the Mexican banking industry, lower prevailing fees and interest rates, and expand access to financial services

With Mexicans desperate for greater access to credit at more reasonable prices, it is no surprise that Banco Walmart was initially viewed as a savior, with the expectation of high customer volume driving down operating costs and consumer credit prices.

Figure 24: Interest Rates of Credit Card Accounts by Percentage of Market Share in Mexico, October 2009

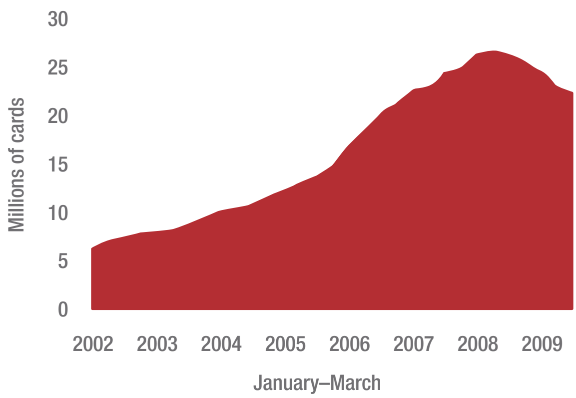


Note: The 28.4% represents the average percentage of account holders that pay off their charges at the end of the month. The 32.3% represents the average percentage of account holders that pay off their charges at the end of the month as well as those that have a revolving balance.

Source: Banco de México 2009.

among unbanked households that comprise the vast majority of the Mexican population (Businessweek 2006; Juhn 2007; Whelan 2008).

Figure 25: Number of Active Consumer Credit Cards in Mexico, 2002–2009



Source: Banco de México 2009.

Not surprisingly, the number of universal, or open-loop, credit cards issued in Mexico grew at a historically unprecedented rate during the economic boom—over 20% per year between 2002 and 2008. These are primarily bank-issued cards that serve the Visa, MasterCard, and American Express transaction platforms. As shown in Figure 25, the number of cardholders soared from about 6 million in early 2002 to over 26.5 million in mid-2008, after which Mexican banks began sharply reducing their consumer lending with the deepening of the global recession. At the end of 2009, the number of universal credit cards in México fell to 22.1 million—a drop of over 15% from the preceding year (Banco de México 2009).[16] Overall, Mexico accounts for less than 5% of all MasterCard and Visa credit cards in Latin America, which suggests the potential for major market expansion in the future (Nilson Report 2009).

Of the 11.9 million universal credit card accounts in Mexico at the end of 2009, 29% were convenience users and paid their charges in full at the end of the month. This compares with about 35% in the United States. The proportion of *clientes no totaleros*, or revolvers, that were current (not past due) and sent minimum and/or partial monthly payments was about 71%. These accountholders had a total outstanding balance of Mex$147.6B, approximately US$11.5B (Banco de México 2009).[17] See Figure 26. This represents an average of US$696 per Mexican credit card account and almost $2,000 outstanding per household. In the United States, there were about 1 billion universal and private-issue credit cards with a total

Figure 26: Mexican Credit Card Market: Number of Accounts, Outstanding Balances, and Interest Rates by Minimum or Full Monthly Payments (2009)

Basic statistics	Cardholders who make minimum/ partial payments	All cardholders (revolving and non-revolving)
Number of cards	8,399,504	11,861,252
Balance of credit given (millions of pesos)	148,672	169,006
Weighted average of effective APRs	32.3%	28.4%
Median of effective APRs	32.9%	29.5%

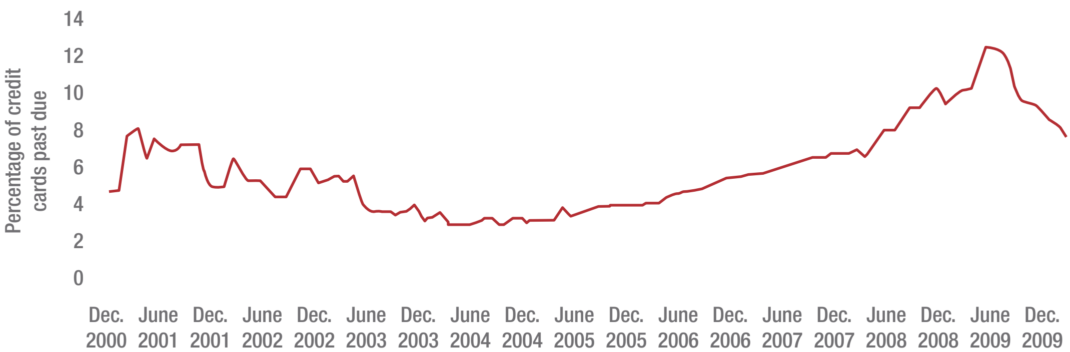
Source: Banco de México 2009.

outstanding balance of $866B at the end of October 2009; about 481 million were Visas and MasterCards (U.S. Federal Reserve 2010). Among U.S. households that revolve their card balances, their average total credit card debt is nearly $20,000.

As in the United States, the Mexican credit card industry has experienced a dramatic increase in credit card defaults—beginning in late 2004—that preceded the economic recession of 2007 with its accompanying surge in near-record levels of un- and underemployment. In May 2004, delinquent payments as a proportion of the total credit card portfolio was only 3.1%, accounting for Mex$2.1B of past-due credit card debt. Over the next three years, as underwriting standards eroded and new credit card accounts grew rapidly (total credit cards doubled), delinquent payments jumped to 5.9% while past-due credit card debt climbed sharply to Mex$14.4B. This is consistent with payment trends in the United States with one exception: Mexicans were much less likely to pay off credit cards with home equity loans and mortgage refinancing. As a result, Mexico experienced a much more abrupt increase in payment delinquencies and defaults. Between April 2007 and May 2009, credit card delinquencies soared to a record 12.6%, with Mex$33.2B in underperforming accounts. Today, following record charge-offs and tighter credit standards, delinquencies have fallen to 7.8% of credit card portfolios and to about Mex$17B in past-due credit card debts (Comisión Nacional Bancaria y de Valores 2009). See Figures 27 and 28.

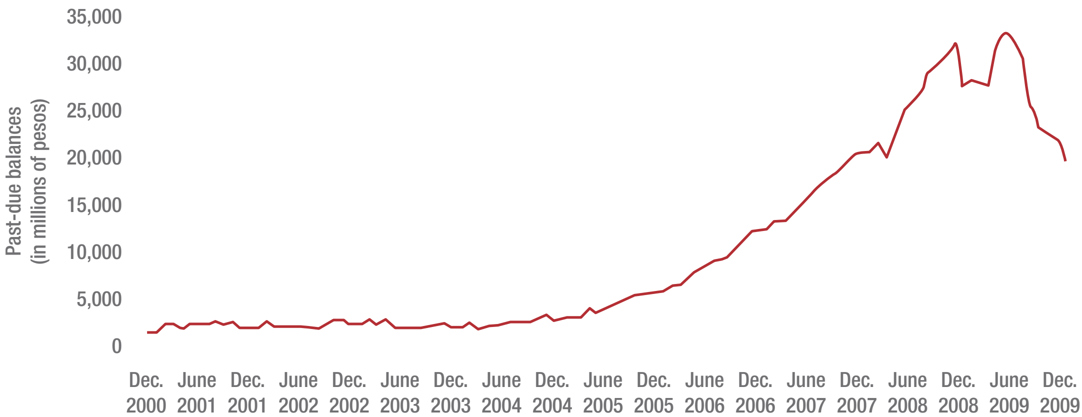
Not surprisingly, the credit card industry is even more concentrated in Mexico than it is in the United States. The top three bank issuers—Bancomer (28.1%), Citibank's Banamex (25.7%), and Santander (17.1%)—account for an astounding 70.9% of all

Figure 27: Past-Due Credit Card Payments Index, 2000–2009 (Past Due Payments/ Total Credit Card Portfolio)



Source: Comisión Nacional Bancaria y de Valores 2009.

Figure 28: Past-Due Credit Card Payments in Millions of Mexican Pesos, 2000–2009

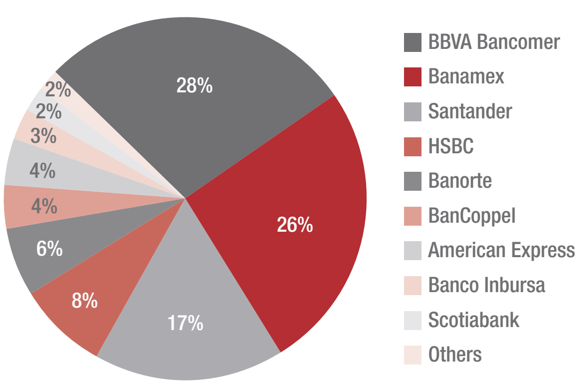


Source: Comisión Nacional Bancaria y de Valores 2009.

> The credit card industry is even more concentrated in Mexico than it is in the United States. The top three bank issuers account for an astounding 70.9% of all universal credit cards issued in Mexico, while the top five account for 85.0%

universal credit cards issued in Mexico (Visa, MasterCard, and American Express), while the top five (including HSBC [8.1%] and Banorte [6.0%]) account for 85.0% (Banco de México 2009). See Figure 29, and Figure 47 in the appendix. In the United States, the "big three"—Chase, Citibank, and Bank of America—control about 63% of the credit card market, and the top five (including Capital One and American Express) about 79% (Card Industry Directory 2009; Manning 2009). In Mexico, the largest card issuers are foreign-owned banks that have exploited their market position by charging much higher APRs than they do in their home countries. This is especially noteworthy since underwriting standards traditionally have been much more stringent in Mexico than in the United States and Europe: Until the early 2000s, credit cards were only issued to higher-income households with established bank accounts and credit histories. At the end of 2009, according to Banco de México (2009), the median annual interest rates (APRs) charged by the largest card issuers in Mexico were 25.0% by Bancomer, 39.9% by Banamex, 33.9% by Santander, 39.5% by HSBC, 34.0%

Figure 29: Mexican Credit Card Industry: Market Share by Bank (2009)



Note: These data include only open-loop credit cards that are not past due or delinquent. Banco Walmart is not included because it did not offer open-loop credit cards until February 2010.

Source: Banco de México 2009.

by Banorte, 67.0% by BanCoppel, 27.0% by American Express, 24.0% by Banco Inbursa, and 30.9% by Scotiabank. Walmart is not included in this list of Mexican card issuers because it only began offering universal Visa credit cards in February 2010.

In sum, the banking industry in Mexico is undergoing profound change as the forces of globalization increase the need for a dynamic, risk-taking banking system. The privatization experiment of 1991–1997 raised critical capital for the Mexican government in its efforts to resolve the national debt crisis. In the process, however, it exacerbated the problems of undercapitalization and industry concentration. The subsequent denationalization phase (1997–2002) injected desperately needed foreign capital for private lending but reinforced the oligopolistic industry structure that maintained the high cost of borrowing (economic risk premium as insurance against future bank expropriations) and the risk aversion of banks, which would lend only to the most creditworthy customers. In an attempt to create incentives that would expand private lending and, in the process, increase competition and lower borrowing costs, federal initiatives have sought to increase consumer credit information for creditors as well as to strengthen private property rights through more effective debt collection laws. This enhanced power of financial institutions, however, has been balanced by greater prudential regulation of banks, more transparency in corporate bank reports, enhanced disclosure of loan terms to consumers, and more vigilant enforcement of consumer rights.

Today, even after its profound transformation over the last 20 years, the Mexican banking industry still plays a surprisingly understated role in the national economy. The current shortage of private credit, which is provided at very high prices, is stifling the growth of the Mexican economy (especially consumer goods and services) at a time when the manufacturing sector is being battered by the competitive pressures of globalization, petroleum income is falling, tourism revenues are slumping, and trade/remittances from the United States are plummeting due to the ongoing international recession. In the present phase of the Mexican banking industry (2003–present), the National Banking Commission of Mexico is seeking to increase market competition by chartering bank subsidiaries of consumer retailers (e.g., Elektra Group's Banco Azteca in 2002, Banco Walmart in 2007) with the goal of expanding consumer credit access to lower-income households at lower prices. Now more than ever, Mexico

> A key question is whether Walmart intends to impose the corporate cost-cutting principles of its retail merchandise division on its financial services division or simply follow the path of other foreign-owned banks that are reaping the economic rents of their oligopolistic market position.

urgently needs a high-volume, low-cost leader in its financial services sector as rising prices and dwindling access to credit are exacerbating Mexico's economic contraction, spurring higher unemployment, and increasing household debt levels. The key question is whether Walmart intends to impose the corporate cost-cutting principles of its retail merchandise division on its financial services division or simply follow the path of other foreign-owned banks that are reaping the economic rents of their oligopolistic market position.

Overcoming the Barriers to Consumer Lending: The Emergence of the Consumer Credit Reporting Industry in Mexico

One of the major impediments to the growth of bank lending to private Mexican businesses and households is the lack of accurate and detailed credit information about borrowers. This is especially important to foreign-owned banks that rely on extensive consumer credit reports in making their underwriting decisions in their home countries. Mexican banks, moreover, have historically managed their risk by restricting lending activities to businesses and families that have existing financial relationships, such as through interrelated boards of directors and socially/politically intertwined kinship networks (Walker 1987; Del Angel-Mobarak 2002; Haber 2003, 2005a). Hence, the Mexican banking system has historically reinforced the social relationships of elite and affluent families with large business networks while excluding middle- and working-class families from the formal commercial bank lending system.

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As the Mexican banking system sought to expand consumer access to domestic credit markets and attract greater foreign investment following the enactment of NAFTA, it was crucial to develop more objective and empirical methods for enhancing its risk assessment tools and risk management policies. One of the major problems in modernizing the credit granting system has been the lack of accurate personal financial information such as that compiled by credit reporting agencies in the United States (e.g., TransUnion, Experian, and Equifax). Since the mid-1990s, Mexican banks and the Mexican government have enacted a series of regulatory reforms to address the dearth of consumer financial file data (financial behavior/activity cross-referenced by personal background information) by allowing private companies to compile personal financial information outside the Mexican judicial system.

In 1995, the first private credit reporting bureau—Buró de Crédito—was established for the express purpose of collecting and improving the accuracy of consumer financial information, albeit based on standards well below the range or quality that is commonly available in the United States and Europe (Negrin 2000). Buró de Crédito began as a joint venture among Fair Isaac, TransUnion de México, and Dun & Bradstreet. Hence, it was capitalized by foreign-owned banks and reporting bureaus. TransUnion de México specializes in reporting the credit history of consumers while Dun & Bradstreet reports the credit history of businesses and corporations. A second credit reporting bureau, Círculo de Crédito, was founded in 2005 and focuses on consumer credit reports. This joint venture is primarily funded by Mexican-owned banks, retail corporations, and private businesspeople (CONDUSEF 2007).

The largest Mexican banks and bank holding companies are the primary contributors and beneficiaries of these new credit reporting agencies. In addition, they possess more than 50% ownership stake in both credit reporting agencies. The remaining equity shares are owned by individuals in the case of Círculo de Crédito and international credit reporting companies in the case of Buró de Crédito (CONDUSEF 2007). The distribution of ownership shares of both credit reporting agencies are reported in Figures 30 and 31.

Figure 30: Ownership Shares of Buró de Crédito

Shareholder	1995	1997
Banamex	18%	18%
Santander	17%	17%
BBVA Bancomer	16%	16%
15 additional banks	18%	18%
TransUnion de México	26%	5%
Fair Isaac	5%	—
Dun & Bradstreet	—	26%
Total	**100%**	**100%**

Source: CONDUSEF 2007.

Figure 31: Ownership Shares of Círculo de Crédito

Shareholder	Participation
Grupo Elektra	18%
Banca Afirme	18%
COPPEL	18%
Individuals	46%
Total	**100%**

Source: CONDUSEF 2007.

The Mexican Ministry of Finance (Secretaría de Hacienda y Crédito Público) is responsible for authorizing credit reporting agencies after receiving approval from Mexico's Central Bank (Banco de México) and the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores). The operational policies of both credit reporting agencies are regulated under the rules of the Credit Information Agencies Law, which was enacted by the Mexican Congress in 2002, as well as the General Laws of the Mexican Central Bank, which provide statutory guidance to Banco de México.

Not surprisingly, consumers' personal financial information is presented in basically the same reporting format as in the United States. For example, consumer credit reports are composed of the following sections:

A. *General Data:* Provides consumer's name, residential address, and employment details.
B. *Credit Summary:* Lists the financial terms and status of each credit account included in the report.
C. *Credit Details:* Summarizes the activities of the credit accounts listed in the credit report, including dates of issuance, payment history, and loan balances.
D. *Third-Party Contacts:* Lists the companies that reviewed the consumer's credit report and the dates of review.

In addition, the Credit Information Agencies Law is closely modeled after U.S. consumer rights credit statutes and establishes the consumer's ability to:

- Access his or her personal information and receive a free credit report every 12 months. It also sets a price limit on the issuance and delivery of additional credit reports.
- Be informed as to who has accessed his or her credit report. Also, the consumer has the right, if denied credit, to request from the lender a copy of the report that was used in the final credit granting decision.
- Correct any identified errors in the credit report issued by either agency.

All the personal financial information summarized in the consumer's credit report is provided by the commercial credit grantors, and this information is retained for six years for both individuals and companies. Like in the United States, information more than six years old is deleted from the credit report. The companies that most commonly supply consumer account information and purchase consumer credit reports in Mexico are banks, nonbank consumer lenders, auto and housing finance companies, department stores, retail stores, and service companies such as cable television and telephone service providers. This increasing use of consumer credit reports in the credit grantor process reflects the greater use of loans and credit in managing Mexican household budgets as well as the entry of new consumer groups into the credit market.

The increased use of consumer credit reports is also a result of greater regulatory scrutiny of banking operations and policies. In the 1990s, the capital requirements of Mexican banks were increased, and more stringent prudential banking regulations established variable capital reserve requirements in accordance with the risk assessment of the bank's portfolio. For instance, Mexican banks are now required to review the credit history of its loan applicants. If a loan is made without checking the borrower's credit report or the borrower's credit history is poor, then these loans must be provisioned at 100% for risk-assessed accounting purposes (Mackey 1999). For Walmart, this new legal infrastructure for systematically collecting and reviewing consumer financial information is crucial to its long-term strategy of improving the understanding of its customers' creditworthiness and thus its strategic expansion into previously underserved, lower-income households. This is a necessary condition for its impending entry into the profitable consumer insurance, auto loan, and home mortgage markets of Mexico.

Debt Collection Practices in Mexico

As the Mexican banking system modernizes its underwriting policies to align with more stringent prudential regulation (federal deposit insurance for savings accounts was implemented in 1986), the second key to reducing lender risk in expansion into new consumer loan markets is enhancements of statutory and institutional enforcement of private property rights. In particular, creditor rights and consumer debt collection laws permit repossessing collateral without the cost and time of going through the judicial system. For instance, current consumer protection laws in Mexico focus on the disclosure and regulation of fees levied by financial institutions but not on how those fees and outstanding or past-due balances are collected (Congress of United Mexican States 2009). Banks, law firms, and debt collection agencies exploit this lack of explicit regulation. They use intimidation practices such as repeated phone calls during the day and even after midnight, delivery of threatening notes, *domiciliary* visits, purchase of informational databases for the purpose of harassing close relatives, and even illegal intimidation such as breaking door locks at debtors' homes (El Diario de Ciudad Juarez 2010).

Current consumer protection laws in Mexico focus on the disclosure and regulation of fees levied by financial institutions but not on how those fees and outstanding or past-due balances are collected.

Banco Azteca, which is part of Mexico's retail giant Grupo Elektra, deploys a cavalry of credit and collection agents on motorbikes to assess the collateral value of a loan applicant's household assets. An agent personally visits the home of the applicant, lists all household appliances, and then calculates the resale value of the items to make the final loan decision. If the accountholder defaults, the bank repossesses the appliances and sells them regardless of the amount due (Epstein and Smith 2007). As a result of these increasingly brazen and abusive debt collection and repossession policies, several new laws are being debated in Mexico that would criminalize abusive debt collection practices. For example, Mexico's House of Representatives introduced legislation in February 2010 that specifies incarceration of three days to one year for harassing consumers, their families, or other third parties such as neighbors and colleagues at work by telephone or in person over delinquent credit card debt. This punishment would apply to employees of banking institutions, law firms, or third-party debt buyer firms that acquire debt portfolios from banks (El Diario de Ciudad Juarez 2010).

The fundamental problem for Mexico's banks is that some types of assets are easier to assign to creditors than others. The ease with which an asset can be assigned depends on several criteria: first, the extent that a collateralized asset is tangible and identifiable; second, its ongoing value in terms of its rate of depreciation; third, the ease of liquidating the asset; and fourth, the cost of repossessing an asset relative to its market value. The less tangible, identifiable, liquid, and inexpensive to repossess the asset is, the more difficult it is to assign it in a credit contract between borrower and lender. In societies with efficient legal systems, these constraints tend not to be limiting factors because the cost of legal enforcement is low and thus a wide range of intangible assets can be assigned to creditors. In societies with inefficient legal systems, like Mexico, these constraints are effectively binding, since they sharply increase the risk to lenders by creating greater uncertainty and much higher costs in the debt collection process (Haber 2005a).

The complexity and cost of debt collection are illustrated by the notoriously inefficient civil judicial process that reflects the long history of social and political struggles in Mexico. At one end of the spectrum are assets such as automobiles that are tangible and identifiable (by vehicle identification number), possess enduring value, and can be sold relatively easily in the used car market. In addition, the cost of repossessing a car is low relative to its asset value. On the other hand, unsecured consumer loans are difficult to collect without tangible assets, and borrowers may be difficult to locate. Even so, it is far easier to track consumers than businesses. Unlike consumers, who have clear and identifiable information for tracking purposes, business enterprises, especially small and mid-sized sole proprietorships and partnerships, can change their corporate identities on a regular basis. Confronted by these constraints, Mexican banks have formulated a complex underwriting system that balances the financial ability of the borrower to repay the loan with the ability of the lender to repossess the collateral and liquidate the asset. As a result, banks have expanded lending for easy-to-repossess automobiles and other consumer durables while demonstrating much less interest in lending for commercial and residential property, unless borrowers meet very stringent criteria. Nevertheless, these new underwriting and debt collection laws and practices have fundamentally changed the historic reluctance of Mexican banks to offer consumer loans.

By working with the executive and legislative branches of the Mexican government, banks have pursued a series of institutional innovations with the objective of circumventing the inefficient bankruptcy courts by legally distinguishing collateralized assets from those included in an individual's or firm's bankruptcy estate. For instance, lenders have promoted popular lease-to-own contracts in automobile financing. Under these innovative contracts, a borrower does not technically purchase a car with financing from a bank. Rather, the bank owns the auto and then leases it to the borrower. The auto depreciation and finance interest rates are the basis for computing the lease payments, which are then structured so that the lender can realize a specified rate of return based on the performance of the borrower and the ability to repossess and liquidate the collateral at fair market value. Upon the expiration of the lease, the customer has paid off the principal and interest of the auto "loan" and the title is transferred from the bank to the "borrower." But, until the final payment is received, the bank retains the title of the car; payment delinquency can automatically trigger the repossession of the vehicle. Another example concerns the difficulty in foreclosing on a private residence. In 2001, a reform of Mexican mortgage contracts permitted replacing liens on secured property with bilateral trusts. These are private contracts whereby the bank serves as both trustee and beneficiary of the trust. If the borrower becomes delinquent on the mortgage payments, the bank can initiate a legal eviction and sell the property at auction. Although debtors can legally challenge the home foreclosure, they are unable to remain in the house during the eviction process. This provides the bank with greater power to negotiate an amicable repossession with the borrower (Haber 2005b; Haber and Musacchio 2005).

The combination of stronger prudential regulation of Mexican banks, more objective and stringent loan underwriting standards as guided by consumer credit reports, and more clearly defined and enforceable private property and debt collections have positively facilitated consumer lending in general and its expansion to underserved Mexican households in particular. This is significant since, according to Haber and Musacchio (2005), the general trend of bank lending since the privatization of the Mexican banking industry has been to retreat from private lending, with foreign banks particularly averse to extending credit for private purposes—especially lower-income, working-class families. They report that between September 1997 and December 2004, the ratio of bank assets allocated to loans for private purposes fell from 50% to 34%.

As previously discussed, private lending has jumped sharply since the early 2000s: from Mex$7,383B in 2000 to Mex$14,889B in 2009 as expressed in 2009 pesos (Comisión Nacional Bancaria y de Valores 2009). Consumer lending registered the largest growth—nearly sixfold over the decade—followed by commercial loans (75.4%) and residential mortgages (51.6%). See Figure 46 in the appendix. With the organizational lending constraints that are self-imposed by the largest Mexican banks and the rapid changes in institutional policies that favor improved underwriting and debt collection practices, Banco Walmart is well positioned to penetrate its target market of over 45 million medium- and low-income unbanked Mexicans who historically have been excluded from any kind of consumer financial services. Furthermore, Walmart is advantaged by not possessing a large number of "legacy" delinquent consumer loan accounts from the early and mid-2000s as is the case with its major competitor, Banco Azteca.[18] With Walmart poised to rapidly expand its consumer financial services offerings in the United States and Mexico, the following section offers insights into the cross-border growth, types of financial services, and operational strategies of Banco Walmart as it expands its retail branch operations and its consumer financial services products that will soon include insurance, auto loans, and residential mortgages.

Low Wages and High Debt Capacity: The Expansion of Consumer Financial Services in Mexico

As the Mexican population has become younger, more concentrated in urban areas, and exposed to the U.S. banking system by both natural growth and migration, the demand for consumer credit has grown sharply over the last two decades. This is due to the demographic transition from largely subsistence lifestyles that are common in rural areas, including collectively owned *ejido* farms, as well as the rising cost of living in Mexican towns and cities. Indeed, the scarcity of credit in the Mexican countryside is a recurrent theme of Mexican peasants, or *compesinos*, whose discontent with the federal government mirrors historic patterns of social and economic inequality. Even in cities, low-income families traditionally have been excluded from the Mexican banking industry, with the general exception of paying bills such as utilities in retail banks. Not surprisingly, lack of banking experience, high service fees, and recent memories of drastic currency devaluations have fostered a general distrust of the Mexican financial system among lower- and middle-income households. For most working-class Mexicans, consumer credit is very scarce, costly, and generally provided by local *tiendas* or small businesses and consumer retail chains such as Grupo Elektra and, more recently, Banco Walmart.

Although the material standard of living of the Mexican working and middle- classes has risen following Mexico's entrance into the GATT and more recently NAFTA, lagging real wages have accentuated the importance of consumer credit in stimulating retail sales. The more prominent role played by in-house finance departments is consistent with the traditional business model of U.S. retailers like Target and Sears. Typically, Mexican retail chains such as Grupo Elektra have offered modified consumer loans that are similar to 12-month rent-to-own contracts (Manning 2000; FDIC 2009). That is, the customer owns the merchandise only after making all contractually agreed-upon payments. Upon missing a single payment, any accumulated equity is relinquished and the merchandise is repossessed by the company (Epstein and Smith 2007). Finance charges for consumer durables such as furniture and kitchen appliances at Grupo Elektra typically range from 120% to 180% APR as offered by its subsidiary, Banco Azteca.[19]

The blended business model used by Banco Walmart in Mexico was initially developed by retail giant Grupo Elektra and further refined with the establishment of the latter's banking subsidiary, Banco Azteca, in 2002. Mexico's first new bank in eight years, Banco Azteca began with 815 branches in 250 cities. Banco Azteca's branches are located inside Grupo Elektra stores, where the parent company has a half-century of experience in providing small, installment loan financing for merchandise purchases; Azteca began with a database of 3 million customers. Banco Azteca also inherited Grupo Elektra's 830,000 savings account customers, who have limited or no access to credit at Mexico's conventional banks (Conger 2003). With the goal of marketing to the nearly 70% of Mexico's underbanked households (about 16 million), with household incomes as low as $250 per month, Azteca allows customers to open savings accounts with only Mex$50 (almost US$5) and earn interest with an average monthly balance of at least Mex$50 (Epstein and Smith 2007). At its inception, Banco Azteca's information platform processed 1 million savings operations and 150 million retail sales and financing transactions every month. During its first three months of operation, the number of Banco Azteca accounts increased by nearly 50%, to 1.2 million, while deposits grew by 150%, to Mex$1.1B.

Significantly, Grupo Elektra's embrace of the fully integrated blended business model includes "sophisticated technology and collection systems [that] provide invaluable data about customers' buying habits and financial needs," according to Azteca CEO Carlos Septién Michel (quoted in Conger 2003).

As previously discussed, since the 2006 election of Mexican President Felipe Calderon, his administration has aggressively sought to improve access to and reduce the cost of retail banking services for low- and middle-income families. As Tricia Juhn, director of *InfoAmericas*' financial services practice, explains,

> *In Mexico, there are only 8 bank branches for every 100,000 people . . . Wal-Mart's ability to tailor financial service offerings by location (just as they do with their off-the-shelf product mix) will translate into lower prices for consumers. The downward pressure on prices should bring down fees industry-wide in the medium-term as other retail banks are forced to respond with competitive product offerings. (Juhn 2007)*

Although most Mexican government and private industry analysts have reiterated this argument ad nauseam since the mid-2000s, there were immediate signs that Walmart's intentions were not consistent with its populist rhetoric. Indeed, with its interest rates for consumer savings accounts set at only 1% (one-half of the prevailing rate) and consumer loan APRs at 75% (Whelan 2008) with inflation at only 4%–5% in 2007, it was clear that Walmart was not interested in pursuing price competition with major commercial banks. This approach contrasts sharply with its corporate mantra: "When costs go down, prices go down . . . [it's] the Walmart way." Clearly, these corporate pricing dynamics do not operate the same way when it comes to Walmart's Financial Services Division—especially in Mexico.

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CHAPTER 5

Banco Walmart: Expansion of Branch Banking and Growth of Consumer Financial Services

Walmart's Mexican financial services unit operates in every way like a traditional bank, with deposit, transaction, and loan products aimed at the mass market. Its products, though basic, are built with large interest rate spreads, making Banco Walmart a key profit driver for the company after just three years.

Figure 32: A Banco Walmart Branch

Although Banco Walmart offers consumer financial services to all Mexican market segments, its product lines are directly targeted to middle- and lower-income households. Walmart's EDLP marketing, the rapid expansion of Walmart retail segments, and the growing volume and loyalty of its customer base enable Walmex/Banco Walmart to successfully capture previously unbanked or unhappily banked consumers (Banco Walmart de México Adelante, S.A. 2009).

While Banco Walmart currently controls a small market share in Mexico, the potential of its services being cost-effectively delivered through over 20,000 point-of-sale cashiers is immense. For example, there were 10,490 retail bank branches in Mexico in September 2009 (see Figure 33). Banamex accounted for 1,588 (15.1%), Banorte 1,079 (10.3%), Azteca 1,179 (11.2%), and Banco Walmart 157 (1.5%). With a total of 23.4 million checking accounts, Banamex is the leader at 9.4 million (40.1%), followed by Banorte at 0.57 million (2.4%), Azteca at 8,713 (0.04%), and Walmart at 3,995 (0.02%). More important is the distribution of the 22.7 million savings accounts. Azteca is the leader at 8 million (35.1%), followed by Banorte at 5 million (21.9%), Banco Walmart at 134,132 (0.6%), and Banamex

Figure 33: Mexican Retail Bank Branches, Checking Accounts, and Savings Accounts: Total Number and Market Share by Bank

	Branches		Checking accounts		Savings accounts	
	Number	Share	Number	Share	Number	Share
Banamex	1,588	15.14%	9,388,750	40.11%	33,347	0.15%
Banorte	1,079	10.29%	565,913	2.42%	4,969,146	21.88%
Azteca	1,179	11.24%	8,713	0.04%	7,980,641	35.14%
Banco Walmart	157	1.50%	3,995	0.02%	134,102	0.59%
Total in Mexico	**10,490**	—	**23,405,166**	—	**22,707,961**	—

Source: Comisión Nacional Bancaria y de Valores 2009.

at 33,347 (0.15%). Banco Walmart's success in attracting low-cost consumer demand deposits is crucial to its expansion into credit card, auto, and mortgage loan markets.

The traditional measures of industry market power, such as number of bank branches, do not adequately reflect the ability of new financial services providers to deliver retail banking services in multiple formats across a wide range of locations. From Banco Walmart's perspective, the branch service point of contact is rapidly evolving into any retail point of contact. Whether purchasing groceries for a daily meal, shopping for school supplies, or making a major purchase such as a new refrigerator, all retail contact is potentially an opportunity for the bank "branch" to serve various consumer financial services needs—for current or future customers. And, with a wide range of Walmex retail groups, Banco Walmart can offer different banking formats and bundles of services that reflect the demands of their different socioeconomic market segments (Juhn 2007).

The rapidly evolving delivery of Mexican consumer financial services in the blended retail POS model is simultaneously driving advances in new information technology and being driven by new IT innovations at the point of sale.[20] The respective consumer service strategy of Walmex for retail merchandise and Banco Walmart for consumer financial services is instructive when compared with industry leader Grupo Elektra and its Banco Azteca subsidiary. This is revealed by examining their branch bank systems along with their ATM networks. As shown in Figure 34, Mexico has 32,446 ATMs, an average of 3.1 ATMs for every retail bank branch, which compares favorably with the U.S. average of 4.1. Banamex has the greatest number of ATMs at 5,606 (a 3.5 ratio of ATMs to branches) whereas Banorte has the highest ratio (4.0) based on 4,348 ATMs. In contrast, Azteca has only 71 ATMs and Banco Walmart has only 1 (Comisión Nacional Bancaria y de Valores 2009). Why? The answer is simple. Grupo Elektra and Walmex do not want their customers visiting remote locations to conduct their financial activities. Instead, they prefer

Figure 34: Mexican Retail Bank Branches and ATMs: Total Number and Ratio by Bank (September 2009)

	Branches	ATMs	
	Number	Number	ATM/Branch ratio
Banamex	1,588	5,606	3.5
Banorte	1,079	4,348	4.0
Azteca	1,179	71	0.1
Banco Walmart	157	1	0
Total in Mexico	**10,490**	**32,446**	**3.1**

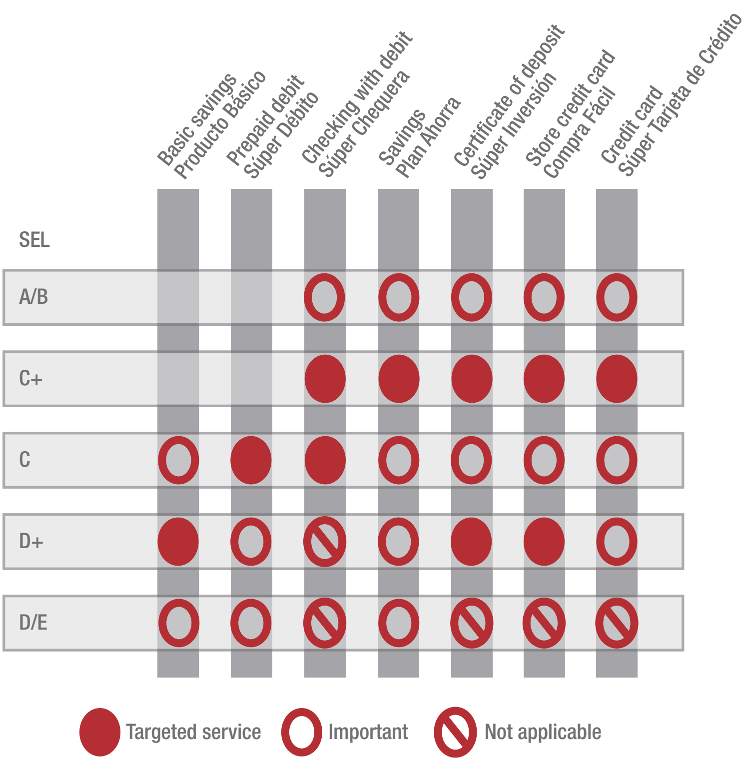
Source: Comisión Nacional Bancaria y de Valores 2009.

that their customers combine banking and shopping tasks during a single trip to their retail stores. Banco Walmart's retail customers can bank in a safe, well-lit, and convenient location while providing Walmex with additional opportunities to sell more retail merchandise.

Banco Walmart currently offers a wide range of consumer financial services, from basic savings accounts to the recently launched open-loop or universal MasterCard credit card. Like many of the Walmart MoneyCenter services in the United States, Banco Walmart offers its customers transactional services that can be easily completed during their regular shopping trips at the bank's branches and at many retail POS cashiers.

The consumer financial products and services offered by Banco Walmart are tailored to the socioeconomic levels of distinct consumer groups. With the middle segments representing the core target areas, these services are intended to satisfy the daily lifestyle needs of lower-income Mexicans. Easy access to electronic payment tools such as prepaid debit cards and checking accounts with debit cards provide consumers with useful payment utilities. The uploading and downloading of household-specific consumption information via these POS platforms assists Walmex in monitoring household retail transactions for developing future mass marketing campaigns as well as modeling consumer financial services needs.

Figure 35: Banco Walmart Product Targeting by Socioeconomic Level



As summarized in Figure 35, Banco Walmart promotes its consumer payment products in a stair-step approach that ranges from a no-frills, low-interest savings account ("Producto Básico") and a prepaid debit payment card ("Súper Débito") to a combined checking/debit card account ("Super Chequera") followed by higher-interest savings/investment accounts ("Plan Ahorra," "Súper Inversión") and then unsecured proprietary store credit ("Compra Fácil") and universal MasterCard credit cards ("Súper Tarjeta de Crédito"). In this way, when a customer is shopping for an appliance at Sam's Club, for example, an in-store credit card (Compra Fácil) can be offered with the value proposition that allows the consumer to set the number of months for repayment. This facilitates the rapid completion of retail sales by the Walmex staff. In the process, immediate access to consumer credit limits the risk that consumers will comparison-shop and potentially make their purchases with competitors. Also, from the blended model perspective, the Walmex sales staff can reduce merchandise prices at the retail store level and still generate more overall corporate profit from the financing contract with Banco Walmart. Hence, this approach increases the consumer debt capacity of lower-income Mexican households while increasing the role of banking products in the daily life of Mexican families.

As Walmart expands its in-store branch banking network, which facilitates the rapid growth of consumer savings, checking, and debit accounts, it is developing a large-scale source of internally generated capital for future consumer loans. The successful growth of its low-cost demand deposits increases the profit margins on Walmart loan products as well as reduces market dependence and price fluctuations on commercial loans and yields from the sale of asset-backed securities (ABSs).[21] The following sections provide an overview of the financial products currently offered by Banco Walmart.

The successful growth of its low-cost demand deposits increases the profit margins on Banco Walmart loan products. It also reduces market dependence and price fluctuations on commercial loans and yields from the sale of asset-backed securities.

Producto Básico (Basic Banking)

The fundamental objective of the blended retail business model is to enhance the total revenues generated by each customer by multiplying the points of contact throughout the retail boundaries of the Walmart economy. This entails three primary sources of consumer revenues: (1) merchandise sales (exclusive of payment-related revenues); (2) finance-related income attributed to in-store merchandise purchases such as from closed-loop credit cards; and (3) financial income attributed to merchandise purchases outside of the Walmart retail network, such open-loop credit cards.[22] The key is that merchandise sales and/or financial revenues can be enhanced to the best advantage of the parent company. For instance, lower merchandise prices can generate higher net profits through favorable lending terms, whereas less desirable lending terms (low teaser-rate financing) may generate higher merchandise sales at premium prices.[23]

In order to cement its relationship with low-income Mexican households, Banco Walmart offers a basic deposit/savings account that does not yield an investment rate of return. Producto Básico provides basic banking services and low-cost transactional services for families

Figure 36: The Producto Básico Financial Account of Banco Walmart: Basic Services and Fees

	Fee
Replacement for lost or stolen card	$3.90
Research fee	$3.90
Cash withdrawal at ATM network of another banking institution	$0.78
Account inquiry at out-of-network ATM	$0.39
Change of PIN at out-of-network ATM	$0.39
International ATM withdrawal	$3.12
Account inquiry at international ATM	$1.56
Additional debit card	$3.90

Source: Banco Walmart de México Adelante 2009.

Note: Mex$1 = US$0.078 (January 27, 2010).

as well as small-business owners. As shown in Figure 36, the fees are very low, ranging from only Mex$0.39 to change PINs at ATM networks of other banks to Mex$3.90 to replace lost cards. The only exceptions are fees associated with international ATM services, which reflect the higher incomes and/or U.S. dollar remittances from migrant workers in the United States.

Súper Débito (Super Debit)—Debit Card

The Súper Débito account is a step up from Producto Básico. It offers Mexican families the ability to open interest-accruing savings accounts with low initial deposits (one-fourth of the minimum required by major banks) that provide the option of making purchases without carrying cash or via online transactions. For example, Banco Walmart requires only a Mex$19.50 minimum deposit, whereas Banamex and Banorte require Mex$78; the latter offer higher interest rates and no monthly account fees. Banco Walmart offers very low account service fees in comparison to large banks, which is consistent with the strategy of branding itself as the low-cost leader of transactional services while maintaining high margins on its consumer loan products. For instance, an international ATM balance inquiry that costs Mex$3 at Banorte is only Mex$0.53 at Banco Walmart.

As noted earlier, Banco Walmart's promotion of low-yield demand deposits among low-income customers is motivated by the need for low-cost funds for increasing the profitability of its consumer lending products. The blended business model further reduces the costs of these services by waiving transactional fees associated with merchandise purchases conducted within the Walmart network of retail stores. Account deposits, withdrawals, and balance inquiries can be made, without charge, at all Banco Walmart branches (cash

Figure 37: Consumer Service Fees for Checking/Debit Accounts and Payment Transactions by Issuing Bank

	Banco Walmart (Plan Ahorra)	Banamex (Cuenta Basica)	Banorte (Banorte Facil)
Minimum monthly average balance required for accrued interest payments	$19.50	$78.00	$78.00
Monthly service account fee	$0.78	$0.00	$0.00
Printed account statement (Walmart first copy printed free in branch)	$1.56	$2.34	$2.34
Additional debit card	$3.90	—	—
Debit card replacement	$3.90	—	$5.85
ATM withdrawal—in network	$0.21	$1.56	$1.48
Balance inquiry at ATM—in network	$0.16	$0.47	$0.70
International ATM withdrawal	$1.12	N/A	$3.00
International ATM balance inquiry	$0.53	N/A	$3.00

Source: Comisión Nacional Bancaria y de Valores 2009.

Note: Mex$1 = US$0.078 (January 27, 2010).

or check) and more than 19,000 POS registers at Walmex shops, clubs, and restaurants (cash only). This policy not only enhances the Walmart brand image as a low-cost financial services provider but it also reinforces customer loyalty to its retail merchandise stores. In fact, Walmart retail purchases made with the Súper Débito card are eligible to earn 1% loyalty rewards.

Súper Chequera (Super Checking)

The Banco Walmart checking account is marketed to higher-income working-class customers and/or small businesses with the goal of more efficiently managing their financial resources.[24] The minimum deposit for the Súper Chequera account is Mex$78—four times more than the Súper Débito account. Interest is earned monthly and is calculated only if the average daily balance is at least Mex$78. The Súper Chequera account includes an electronic debit card and traditional paper checkbook. The first three checks or transactions as well as the monthly statement are free, with a Mex$1.95 fee if the account balance falls below the monthly minimum. Banamex, in comparison, requires a minimum deposit of Mex$156, and its monthly maintenance fee is Mex$15.21 if the account balance falls below the monthly minimum. Other account service fees, such as ATM withdrawals and balance inquiries, cost 6–10 times more at the large banks, with the exception of international ATM transactions, which are 3–5 times more expensive; in-branch withdrawals and balance inquiries are free at Banco Walmart versus Mex$2.34 at Banorte and Banamex. The

> Walmart's blended model entails more points of customer contact with the purchase of future bundles of merchandise and financial services on both sides of the U.S.–Mexico border.

Figure 38: Consumer Service Fees for Super Checking/Debit Accounts and Payment Transactions by Issuing Bank

	Banco Walmart	Banamex	Banorte
Minimum opening amount	$78.00	$156.00	$78.00
Minimum monthly balance required	$78.00	$156.00	N/A
Monthly fee	$0.00	$0.00	$3.51
Withdrawal or balance inquiry at window	$0.00	$2.34	$2.34
Transfer between accounts	$0.00	$0.00	$0.00
Below minimum balance fee	$1.95	$15.21	N/A
ATM withdrawal—in network	$0.21	$1.56	$1.48
Balance inquiry at ATM—in network	$0.16	$0.00	$1.70
International ATM withdrawal	$1.12	N/A	$3.00
International ATM balance inquiry	$0.53	N/A	$3.00

Source: Comisión Nacional Bancaria y de Valores 2009.

Note: Mex$1 = US$0.078 (January 27, 2010).

higher cost of international transactions at Banco Walmart is instructive. Walmart's blended model entails more points of customer contact with the purchase of future bundles of merchandise *and* financial services on both sides of the U.S.–Mexico border. The growing binational economy of Mexicans working in the United States and purchasing goods and services at Walmart includes sending U.S. dollar remittances via low-cost MoneyGrams to family members in Mexico for purchasing merchandise at the local Walmart.

Plan Ahorra (Basic Savings Account)

Plan Ahorra is a basic savings account that yields a low interest rate based on maintaining a minimum balance. It includes an electronic debit card for cash withdrawals, which can be used within and outside the Banco Walmart branch and ATM network throughout Mexico and even in the United States. Except for international ATM withdrawals, Banco Walmart transaction and service fees are lower than those of the large commercial banks. However, interest rates tend to be lower at Banco Walmart with the assumption that low-income households are opening savings accounts for convenience during their shopping trips at Walmart retail stores rather than seeking the highest returns on their savings. Indeed, its major competitor Azteca consistently offered about twice the rate of Banco Walmart (3.2% vs. 1.6%) as of December 2009. Other banks offer higher and lower rates: Inbursa 4.4%, American

Except for international ATM withdrawals, Banco Walmart's transaction/service fees are less costly than those of the large commercial banks. However, interest rate yields tend to be lower at Banco Walmart, too.

Figure 39: Consumer Service Fees for Basic Savings Account and Interest Rates by Bank

	Banco Walmart	Banamex	Banorte
Replacement for lost or stolen card	$3.90	$7.80	$5.85
Minimum balance	$0.78	$0.00	$0.00
Additional statement printing	$3.90	$7.80	$11.70
ATM withdrawal—another institution's network	$0.78	$1.56	$1.48
ATM balance inquiry—another institution's network	$0.39	$0.47	$0.70
International ATM withdrawal	$3.12	N/A	$3.00
Additional debit card	$3.90	N/A	N/A
Interest rates			
Balance under $3.90	0.00%	—	—
Balance from $3.90 to $195.00	0.70%	—	—
Balance from $195.01 to $390.00	1.40%	—	—
Balance over $390.00	2.50%	—	—

Source: Comisión Nacional Bancaria y de Valores 2009.

Note: Mex$1 = US$0.078 (January 27, 2010).

Express 3.6%, JP Morgan 2.4%, Banco Autofin 1.7%, Scotiabank 1.1%, Banamex 1.0%, Bancomer 0.8%, and Banorte 0.6% (Comisión Nacional Bancaria y de Valores 2009).

Súper Inversión (Super Investment)—Certificate of Deposit (CD)

The Súper Inversión is a time deposit account of 7, 28, 90, 180, or 360 days. The yields are based on a percentage of 28-day CETES, which are CDs issued by Mexico's Department of Treasury. Walmart customers can choose the length of time and investment amount according to their needs and preferred return. Accounts are opened by transferring funds from existing Banco Walmart Plan Ahorra, Súper Débito, or Súper Chequera accounts. The interest rate is calculated daily and compounded through the term of the CD according to the agreed-upon interest rate divided by 360 days and multiplied by the number of days of the investment. Starting at only Mex$390, the Súper Inversión CD is affordable and offers customers an easy to understand and predictable investment option. As a result, this is a new source of income for unbanked households, and it is advertised as a safe, guaranteed investment vehicle. As the bank advertisements exclaim, "You just wait for your money to grow!"

For working-class Mexicans with memories of drastic currency devaluations and triple-digit inflation, the lack of trust in the Mexican banking system is difficult to overcome. Indeed, compound interest investment products have not been previously available to most low-income Mexicans, and they are not familiar with interest-bearing accounts. With Banco Walmart offering the Súper Inversión

CDs rather than the Mexican government, there is a greater likelihood that low-income Mexicans will trust Walmart with their savings and, in the process, provide a growing source of low-cost funds for future consumer lending by Banco Walmart. At 5.0% APR, Banco Walmart's interest rate is substantially below competitors like Banco Facil (7.4%) and Azteca (7.2%) and similar to many other large banks such as Banco Autofin (5.2%), Inbursa (4.7%), American Express (4.5%), and Scotiabank (4.1%). ING (7.7%) offers the highest rate, while the lowest include Bancomer (4.3%), Banorte (3.7%), and Banamex (3.2%) (Comisión Nacional Bancaria y de Valores 2009).

Compra Fácil (Easy Buying/Purchasing)—Closed-Loop or Proprietary Retail Credit Cards

The most significant financial services offered by Banco Walmart are the unsecured credit products. Compra Fácil is a closed-loop, proprietary retail credit card that can only be used for purchases at Walmex stores and clubs (Walmart Supercenter, Bodega Aurrera, Superama, Sam's Club, and Suburbia). The line of credit ranges from Mex$117 to Mex$3,857. After the loan is approved (the application is processed in about two hours), a fixed interest rate is determined and the customer chooses the repayment period (12, 18, or 24 months) with weekly, biweekly, or monthly payments. Significantly, Banco Walmart does not require a review of the consumer's credit report to approve a credit card loan. Loan payments can be swiftly processed at POS registers at most Walmart Supercenter, Bodega Aurrera, Sam's Club, and Suburbia retail outlets.

With the Compra Fácil credit card program, consumers can immediately purchase clothing, electronics, and appliances as well as negotiate the terms of their repayment agreements. In comparison to major bank competitors, the minimum monthly salary requirement of only Mex$117 is much lower than the Mex$312 of Banamex and Mex$234 of Banorte. Although Banco Walmart imposes no annual membership fee (Banamex charges Mex$34.30 and Banorte Mex$30.80) and only a modest card replacement fee of Mex$3.90 (compared to Mex$10.10 by Banamex and Mex$19.00 by Banorte), its annual finance rate of 59%–75% APR is *three times higher* than Banorte (19.9% APR) and about twice the cost of Banamex at 36.2% APR. Like in the United States, Walmart is maintaining the price structure of the upper-tier APRs. So far, Banco Walmart does not appear interested in initiating price competition with large retail banks and is piggybacking its "low-cost leader" image in retail

> The mounting demand for consumer credit by lower- and middle-income Mexicans is being supplied by Walmart, but at rates that are shockingly high by U.S. industry standards.

Figure 40: Consumer Credit Card Account Fees and Interest Rates for Closed-Loop Retail Credit Cards by Issuing Bank

	Banco Walmart	Banamex	Banorte
Minimum monthly income	$117.00	$312.00	$234.00
Annual fee	$0.00	$34.32	$30.81
Card replacement fee	$3.90	$10.14	$18.99
APR	59%–75%	36.2%	19.9%

Source: Comisión Nacional Bancaria y de Valores 2009.

Note: Mex$1 = US$0.078 (January 27, 2010).

merchandise to imply a similar approach in its Financial Services Division. Consequently, the mounting demand for consumer credit by lower- and middle-income Mexicans is being supplied by Walmart, albeit at rates that are shockingly high by U.S. industry standards.

Súper Tarjeta de Crédito—Open-Loop or Universal Bank-Issued Credit Cards

In February of 2010, Banco Walmart launched its open-loop, or universal, bank-issued MasterCard. This was a watershed event. By issuing a universal credit card, Banco Walmart officially shifted its strategy from an in-house finance division, with the primary goal of increasing retail merchandise sales and reducing merchant processing fees while secondarily increasing finance revenues, to competing with major banks over consumer finance revenues, penalty fees, and merchant fees generated from sales *outside* of the Walmex network of retail stores. This new consumer loan product will be followed by auto loans, mortgages, and insurance. Although the annual membership fee ($18.72 versus $34.32) and card replacement fee ($3.90 versus $18.99) are much lower in the Banco Walmart MasterCard program, as expected, it is the APR that is most revealing. As reported in Figure 41, the comparable open-loop credit card of Banorte is 19.9% APR and Banamex is 36.2% APR. The Walmart MasterCard, in comparison, charges an APR of 45%–60%, even though inflation in Mexico is stable at a historically low level of 5%. Clearly, at this time, Banco Walmart is not pursuing a strategy of price competition with the major Mexican banks.

Figure 41: Consumer Credit Card Account Fees and Interest Rates for Open-Loop Retail Credit Cards by Issuing Bank

	Banco Walmart	Banamex	Banorte
Card replacement fee	$3.90	$10.14	$18.99
Annual fee	$18.72	$34.32	$9.36
Interest rate (Variable)	45%–60%	36.2%	19.9%

Source: Comisión Nacional Bancaria y de Valores 2009.

Note: Mex$1 = US$0.078 (January 27, 2010).

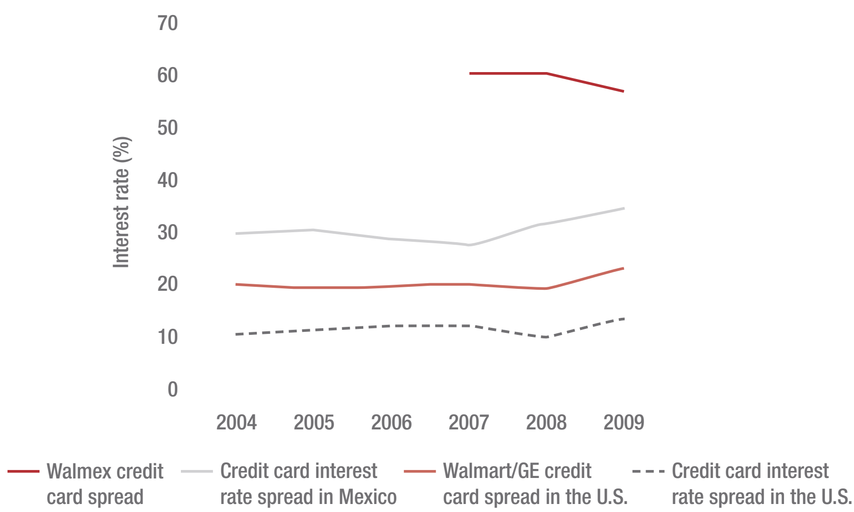
Of course, Walmart is not abandoning the blended business model in Mexico. In an effort to enhance customer loyalty, all Banco Walmart MasterCard purchases at the Walmex group of stores, clubs, and restaurants (Bodega Aurrera, Sam's Club, Suburbia, Superama, Vips, and Walmart) are rewarded with a bonus of up to 5%. Also, Banco Walmart offers the cardholder an option to skip the minimum payment or a monthly fixed payment once every six months, although interest on the revolving balance continues to accrue. Banco Walmart MasterCard cardholders can make payments at more than 19,000 POS cashiers at all shops, clubs, and restaurants in the Walmex group as well as at Banco Walmart branches. The loyalty reward bonus, ranging from 2% to 5% of purchases, is earned only by customers who pay on time each month. For customers who are late on one payment, the penalty is 50% of the accumulated bonus. With two or more late payments, the customer forfeits all accumulated reward points.

A comparison of Walmart's lending rates in the United States and Mexico offers further insights. As presented in Figure 42, the credit card interest rate spread on GE-partnered open-loop credit card accounts (averaging 24.9%) is about 11 percentage points above or nearly double the U.S. credit card industry's average spread in 2009. This is especially high considering that U.S. inflation and cost of funds were almost zero in 2009. The interest rate spread of Walmart's revolving credit cards in the United States would be even greater if subprime loan products such as the Salute Visa credit card were included or the triple-digit interest rates (120%–300% APR) of partner Jackson Hewitt's RALs. Similarly, the interest rates of Walmart's consumer credit cards in Mexico, where the average credit card APR is about 40%, typically range from 55% to 70% APR.[25] Therefore, rather than being the low-cost leader in Mexico and reducing the cost of borrowing for lower- and middle-income Mexicans, Walmart is strongly defending the upper-tier interest rates, to the chagrin of Mexican bank regulators and consumers alike. In comparison to the average credit card interest rate spread in the United States, the Walmart "effect" is astonishing: about 60% APR in Mexico versus the U.S. industry average of less than 15% APR. This suggests that the profit margins for Walmex financial services will offer a huge financial advantage in competition against its major retail competitors in Mexico.

In comparison to the average credit card interest rate spread in the United States, the Walmart "effect" is astonishing: about 60% APR in Mexico versus the U.S. industry average of less than 15% APR.

With high profit margins, Banco Walmart offers a potential war chest for Walmart's Financial Services Division. Indeed, Banco

Figure 42: Walmart Credit Card Interest Rate Spread, Mexico vs. United States, 2004–2009



Sources: Banco de México, CPI Consumer Price Index Table, available at www.banxico.org.mx/sitioingles/PortalesEspecializados/inflacion/indicators.html; Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release, Table H.15 Selected Interest Rates, available at www.federalreserve.gov/releases/h15/current/h15.htm; U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers (CPI-U), available at ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt.

Walmart CEO Eduardo Solozano projects an operating profit after only three years even while rapidly expanding its branch banking infrastructure (Bell and Burritt 2008). This is impressive, since Walmart did not acquire a commercial bank with a large branch network and it has just begun to offer consumer (closed-loop followed by open-loop) credit cards with installment loans (autos, mortgages) and insurance products to follow. Banco Walmart's performance is particularly striking since it is Walmart's initial banking venture in a developing Latin American country and its core customer segments feature low household incomes, especially by U.S. standards. Furthermore, the growing high-margin revenue stream from Banco Walmart operations will provide a profit cushion for the aggressive expansion of new retail banking operations in North American consumer markets. In fact, Walmart only recently received a bank charter for Walmart Canada Bank/La Banque Walmart du Canada in July 2009.[26] The competitive landscape in Canada includes Loblaw Cos., the country's biggest supermarket chain, and auto-supplies retailer Canadian Tire Corp. Both retail companies obtained charters from the Canadian government to operate banks, and both currently offer low-interest loans and mortgages as well as credit cards (Bell and Burritt 2008). Hence, in the near term, the high profit margins of Banco Walmart will attenuate the start-up costs and early losses of its rapidly growing North American Financial Services Division.

Banco Walmart: Assessing the Impact on Mexican Banking and Consumer Credit

With the disappointing performance of the Mexican economy under the free-trade regime of NAFTA, the growth of remittances from Mexican workers in the United States and the increasing importance of the Mexican consumer services sector have elevated the importance of un- and underbanked households to the Mexican economy. That is, the in-house finance departments of retail chains and the more efficient conversion of Mexican remittances into electronic payment cards have increased the effective consumer demand of low- and middle-income households that lack retail banking relationships. Indeed, the most widely used "bank" in Mexico traditionally has been the Monte de Piedad (Mountain of Pity), the national pawn shop where, depending upon the rate of inflation, the interest rates can be less than those offered by large retail banks.

Although Banco Walmart's competitive impact on large Mexican banks has been modest over the last two years, as reflected by the lack of price reductions in consumer lending rates, its future market expansion could be prodigious. This is because the Comisión Nacional Bancaria y de Valores (CNBV), or National Banking and Securities Commission, approved legislation in April 2009 that allows banks to conduct business through "correspondents" for branch banking activities. Under this structure, banks are permitted to conduct financial transactions for their clients through third parties such as commercial and department store chains, grocery stores, pharmacies, gas stations, and convenience stores (Román Pineda 2010). Consumers are able to transact account deposits, cash withdrawals, and loan account payments as well as check their account balances through bank correspondents. During the first 18 months, a maximum of 65% of the bank's consumer financial services can be conducted through correspondents, with the limit reduced to 50% thereafter. This law also limits transaction amounts to 1,500 *unidades de inversión* (UDIs), cash withdrawals and cashing checks to approximately Mex$6,000 (US$468), and deposits to 4,000 UDIs, which corresponds to Mex$16,000 or about US$1,250 (Latin America Advisor 2009).

The Mexican banking industry is currently dominated by four large banks with extensive branch networks. At the end of September 2009, BBVA Bancomer had 1,838 branches, Banamex had 1,590 branches, HSBC had 1,190 branches, Azteca had 1,179, and Santander had 1,054; Walmart only had 157 (Comisión Nacional Bancaria y de Valores 2009). With the enactment of this new regulatory framework, Banco Walmart will be able to compete with the bank branch networks of these industry leaders without major investments in new physical infrastructure. It also offers the advantage of extending Banco Walmart's operating hours and providing more customer security than ATMs, which are the primary "extended hours" option for customers of commercial banks. Hence, this strategy will quickly expand Banco Walmart's operational capacity to a scale that is comparable to some of Mexico's largest banks. And, it could be adopted in the United States as a more cost-efficient method of expanding Walmart's branch banking network for competing with credit unions and commercial banks.

As a federal bank regulator, the CNBV indirectly supervises Mexican bank correspondents. This regulatory agency must approve the operations manuals of bank correspondents and receive monthly reports from banks that detail all of their correspondents' banking activities (Notimex 2009). The CNBV can penalize a specific bank and even suspend the banking activities of its correspondents if it encounters violations in their operations. Indeed, banks are responsible for the operations of their third-party correspondents since they function as de facto bank branches. At present, the Mexican Banking Commission has granted authority to the following banks to employ correspondents: American Express, Banamex, BBVA Bancomer, Banorte, Compartamos, HSBC, Inbursa, Invex, Scotiabank, and Banco Walmart (Román Pineda 2010). In October 2009, Banco Walmart launched the first stage of its correspondent program, offering authorized financial services through 29 of its retail stores. With this new correspondent system, Banco Walmart's customers will have access to basic financial services through approximately 19,000 cash registers strategically located throughout Walmex's more than 1,300 supermarkets, stores, clubs, and restaurants (Román Pineda 2010).

Soon after the National Banking Commission of Mexico authorized Banco Walmart to operate a correspondent network, Banco Compartamos, S.A., a Mexican company that provides microfinance loans to small companies and entrepreneurs, applied for a license to expand its banking services through third-party correspondents. This was a direct response to competition from Banco Walmart and Grupo Financiero Inbursa; the goal is to enable mom-and-pop stores in rural villages to accept demand deposits and make loans to the company's 1.4 million customers. Banco Compartamos already has a bank charter that allows it to accept deposits as well as offer microloans, and it has now dramatically expanded its branch banking capabilities. Therefore, this new licensing authority constitutes the next step in managing its customers' savings, since they are already lending money to them (Schmall 2009). In addition, in September 2009 the Mexican bank Inbursa announced plans to operate a not-for-profit company with renowned Nobel Prize winner Muhammad Yunus. Its goal is to offer microloans to low-income Mexicans for starting microenterprises. Inbursa's microlending program is modeled after Grameen Bank, which pioneered the underwriting of microloans for entrepreneurial ventures in poor nations with the goal of promoting economic and social self-sufficiency. The goal of the Inbursa program is to offer 100,000 small loans throughout Latin America over the next five years (Schmall 2009).

Although Banco Walmart's aggressive expansion in Mexico has spurred opposition from local activists and precipitated aggressive responses from community-based lending programs, it has generally been warmly received by the national media and general public. This lack of organized opposition to Walmart's retail banking activities is largely due to negative attitudes toward the major commercial banks as well as the populist image that Walmart has shaped throughout its expansion into retail banking. Indeed, it is hard to oppose Walmart's efforts to offer basic financial services to the majority of Mexicans who historically have been excluded from the commercial banking industry. And, allowing retail store chains to offer consumer financial services can only increase competition and eventually reduce the high cost of these banking services. Right?

Although Banco Walmart's aggressive expansion in Mexico has spurred opposition from local activists and precipitated aggressive responses from community-based lending programs, it has generally been warmly received by the national media and general public. Walmart benefits from negative attitudes toward the major commercial banks as well as the populist image that it has shaped throughout its expansion into retail banking.

Based on its successful growth in Mexico, Walmart announced on February 15, 2010, the next phase of its ambitious Latin American expansion plans: the formation of *Walmart Centroamerica*. With this new regional focus, Walmart's retail operations have expanded into six countries: Mexico, Guatemala, Nicaragua, Honduras, Costa Rica, and El Salvador. The most significant difference with Walmart's Mexican and Central American retail store expansion strategy, in comparison to the United States, is the focus on major cities rather than small towns in the countryside. This is not a surprising shift in the Walmart business model, since rural populations lack sufficient income for shopping at Walmart retail stores. The exception is those households that receive financial remittances from workers in the United States. These households, however, can travel to nearby cities to make their purchases at Walmart.

CHAPTER 6
Conclusion

Walmart's failure to win a U.S. banking charter was only the end of a chapter, not the end of the story. The company's full-service consumer bank in Mexico gives it both a profit center there and a training ground for an eventual banking foray into the United States. But even Walmart's current MoneyCenters are a competitive threat to credit unions, one they simply cannot ignore.

The decision of the U.S. Congress and FDIC to suspend the issuance of new ILC charters in spring 2007 provides a unique opportunity to investigate the short- and long-term retail banking interests of Walmart. During the public hearings, Walmart emphasized that its primary goal in acquiring a national bank was to reduce its transaction costs (especially merchant interchange fees) and increase the availability of consumer credit for the purchase of Walmart merchandise through the issuance of proprietary and universal credit cards like its major competitor, Target. The universal credit cards would also generate finance and penalty fee revenues for purchases outside of the Walmart retail system. Significantly, Walmart emphatically declared that it did not intend to pursue branch banking in the United States and was not interested in offering auto loans, mortgages, or insurance products.

At the same time that Walmart was denied a bank charter by the U.S. government, it was granted a bank charter by the Mexican government: Banco Walmart de México Adelante, S.A. This provided a unique opportunity to directly test the Walmart assertion that its banking activities would be limited to offering basic consumer financial transactional services, developing payment processing systems (debit, credit card, check), and marketing consumer credit products like credit cards for increasing traditional merchandise sales. On the contrary, as previously explained, Banco Walmart has aggressively established an extensive branch banking network that will include an enormous third-party correspondent system of branch outlets. In the process, Banco Walmart has aggressively pursued consumer saving and checking deposits that reduce its cost of consumer lending. More recently, it followed the issuance of its closed-loop proprietary credit card with the launch of an open-loop universal MasterCard in February 2010. Banco Walmart's impressive branch banking network is expected to soon offer auto loans, mortgages, and insurance. And, on the U.S. side of the border, Walmart has embarked on an ambitious campaign to establish a consumer financial services MoneyCenter in nearly 40% of all Walmart Supercenters by the end of 2010. With its global economy of scale, Walmart's banking subsidiaries could fuel the growth of one of the world's largest investment banks that could package and sell its consumer loans through a wide range of ABS products.

The formidable blended business model that Walmart is developing in Mexico poses some nearly insurmountable competitive advantages after it is imported to the United States. That is, the fundamental objective of the evolving Walmart business model is to maximize the total revenues generated by each customer by multiplying the points of contact throughout the retail boundaries of the Walmart economy. Currently, this entails four primary sources of consumer revenues: (1) merchandise sales (exclusive of payment-related revenues); (2) finance-related income attributed to in-store merchandise purchases, such as those made with closed-loop credit cards; (3) financial income attributed to merchandise purchases outside of the Walmart retail network such open-loop credit cards; and (4) transactional revenues from check cashing, money orders, money wires, and bill payment services. A fifth and much larger revenue stream soon will be added that includes finance and fee revenues from consumer installment loans and insurance products. Significantly, Walmart has not pursued a low-cost leader strategy in marketing its consumer loans—on either side of the border. In fact, rather than driving down the cost of borrowing, Walmart has defended the upper price tiers while defying the expectation that it would generate greater competitive pricing pressures.

The key to the blended Walmart business model is that merchandise sales and/or financial revenues can be cultivated to the best advantage of the parent company. For instance, lower merchandise prices can generate higher net profits through favorable lending terms, whereas less desirable lending terms (low teaser-rate financing) may generate higher merchandise sales at premium prices. Furthermore, by enhancing overall corporate profits, Banco Walmart's financial services division offers an enormous potential war chest for subsidizing short-term price and profit reductions in its U.S. operations against both retail merchandise and banking competitors.

The inevitable entry of Walmart into the U.S. retail banking market will occur in the aftermath of the worst recession since the Great Depression of the 1930s. This is significant for three reasons. First, many credit unions and commercial banks have been severely hampered by their financial difficulties and will have fewer resources for effectively responding to the competitive challenges of Walmart. Second, it will take many years for U.S. financial institutions to absorb the continuing losses from imprudent legacy consumer and commercial loans. Third, the failure of credit unions to embrace distinctly different operational policies that differentiate credit unions from commercial competitors will severely handicap the branding of credit unions as the "people's bank" and limit their appeal to those seeking alternatives to the greedy policies of major commercial banks. In contrast, Walmart will enter the U.S. retail banking industry with high levels of capitalization, a clean slate of performing loans, and a carefully coordinated and well-funded marketing campaign that will appeal to the populist, anti–Wall Street sentiments of working and middle-income households. And, with more financial pressures on the U.S. banking industry on the horizon (such as next wave of real estate foreclosures) resulting in greater bank insolvencies and tighter consumer credit due to lender liquidity problems, Walmart is poised to portray itself as the financial savior of low-income families—both in terms of lower merchandise prices and "affordable" consumer credit. Furthermore, it is not outside the realm of possibility that the break-up of a "too big to fail" commercial bank like Citi could provide a fortuitous opportunity for Walmart to come to the rescue as the proverbial white knight.

Walmart will enter the U.S. retail banking industry with high levels of capitalization, a clean slate of performing loans, and a carefully coordinated and well-funded marketing campaign that will appeal to the populist, anti–Wall Street sentiments of working and middle-income households.

Walmart is already creating short- and long-term competitive and sustainability problems for credit unions through the rapid expansion of its MoneyCenters with partnered financial services providers. Indeed, Walmart's MoneyCenters are attracting typical new credit union members (young, minority, immigrant, lower-income, blue-collar, early career, young families), especially those in un- and underbanked households. In addition, the current recession has brought more middle-income families to Walmart, many of whom will combine their retail shopping with personal finance tasks. Together with the ineffectual credit union campaign to attract disaffected commercial bank customers, Walmart's experience in Mexico suggests that it will persuasively portray itself as a populist alternative to the greedy and capricious policies of the large Wall Street banks. And, based on its successful expansion in Mexico, Banco Walmart is developing enduring loyalty with a major consumer segment before it arrives in the United States.

Walmart's MoneyCenters are attracting typical new credit union members (young, minority, immigrant, lower-income, blue-collar, early career, young families), especially those in un- and underbanked households.

Walmart's entry into the Mexican consumer lending market is revealing when compared with its MoneyCenters in the United States. As previously discussed, Walmart has *not* sought to aggressively reduce the interest rates of its MoneyCenter loan providers as is typical with its retail merchandise suppliers. In fact, it has offered extremely high interest rates that often exceed 120%–240% APR through subprime Visa credit cards (CompuCredit–Urban Trust Bank partnership) and Jackson Hewitt RALs. Even its partnership with GE Money Bank offers Visa credit cards with APRs from 22.9% to 28.9%, 50%–100% more than the national average of approximately 14.5%; the latter include a GE Money charge card that is marketed to a key credit union market—small business owners.

> With much higher profit margins in its financial services division, Walmart is pursuing a profit-maximizing strategy rather than aggressively increasing its market share through its traditional low-cost marketing campaigns.

Unlike its merchandise division, Walmart's current operational strategy is to maintain high profit margins on its loan products rather than negotiating lower interest rates on behalf of its customers. With much higher profit margins in its financial services division, Walmart is pursuing a profit-maximizing strategy rather than aggressively increasing its market share through its traditional low-cost marketing campaigns. Indeed, Walmart's loan products are typically much more expensive than those offered by credit unions, which is surprising due to the competitive price structure of its transactional products (cash checking, bill payment, prepaid debit cards). This offers a major market opportunity for credit unions, since Walmart's current pricing policy is to charge what "the market will bear" with many of its customers maxed out on their credit lines, unbanked, or unfamiliar with the U.S. borrowing market.

> If credit unions do not aggressively and proactively prepare for the impending arrival of the Bank of Walmart, then a major portion of the credit union system—at least 30%—will immediately find themselves unable to compete with the blended business model of the Walmart banking juggernaut.

Without an aggressive marketing campaign with strategic retail partners and the embrace of new operational policies that differentiate credit unions from commercial banks (e.g., loan underwriting, mortgage modifications, collections), the practical reality facing credit unions is whether Walmart's MoneyCenters will further obscure the credit union/bank distinction and consumers will not care. For example, the Fair Trade campaign has been successful by identifying the "good guys" in the production process (environment, labor) and explaining why the support of socially responsible products benefits everyone—producers and consumers. Even Walmart has relented to public pressure and embraced Fair Trade and ecologically sustainable practices in the sourcing of its coffee and wood-based furniture products (Holahan 2009). Consequently, if credit unions do not aggressively and proactively prepare for the impending arrival of the Bank of Walmart, then a major portion of the credit union system—at least 30%—will immediately find themselves unable to compete with the blended business model of the Walmart banking juggernaut.

Characteristics of U.S. Industrial Loan Companies, Borrowing Trends in Mexico, and Mexican Credit Cards

Figure 43: Comparison of ILCs and Commercial Bank Holding Corporations: Key Differences in Powers by Bank Charter

Powers	State commercial bank that is a Bank Holding Company Act (BHCA) bank	ILC (or industrial bank) that is not a BHCA bank
Ability to accept demand deposits	Yes	Varies with the particular state. Where authorized by the state, demand deposits can be offered if either the ILC's assets are less than $100 million or the ILC has not been acquired after August 10, 1987
Ability to export interest rates	Yes	Yes
Ability to branch interstate	Yes	Yes
Ability to offer full range of deposits and loans	Yes	Yes, including NOW accounts, but see the first entry above regarding demand deposit accounts
Authorized in every state	Yes	No. ILCs currently are chartered in seven states*
Examination, supervision, and regulation by federal banking agency	Yes	Yes
FDIC may conduct limited scope exam of affiliates	Yes	Yes
Golden Parachute restrictions apply	Yes	Yes, to the institution; no, to the parent
Cross Guarantee liability applies	Yes	No
23A & 23B, Reg. O, CRA apply	Yes	Yes
Anti-tying restrictions apply	Yes	Yes
Parent** subject to umbrella federal oversight	Yes	No
Parent** activities generally limited to banking and financial activities	Yes	No
Parent** could be prohibited from commencing new activities if a subsidiary depository institution has a CRA rating that falls below satisfactory	Yes	No
Parent** could be ordered by a federal banking agency to divest of a depository institution subsidiary if the subsidiary becomes less than well capitalized	Yes	No
Full range of enforcement actions can be applied to the subsidiary depository institutions if parent fails to maintain adequate capitalization	Yes	Yes
Control owners who have caused a loss to a failed institution may be subject to personal liability	Yes	Yes

Source: Federal Deposit Insurance Corporation, Supervisory Insights. www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html.

Notes: NOW = negotiable order of withdrawal; CRA = Community Reinvestment Act.

*California, Colorado, Hawaii, Indiana, Minnesota, Nevada, and Utah.

**Parent, with respect to a state commercial bank, refers to a bank holding company or financial holding company subject to supervision by the Federal Reserve. Under a proposed rule, broker-dealers who own ILCs may soon be able to choose consolidated supervision by the Securities and Exchange Commission. See "Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities," 62 Fed. Reg. 62872 (proposed November 6, 2003, to be codified at 17 C.F.R. Part 240).

Figure 44: Top 20 ILCs Ranked by Total Assets

Insured	Institution	Total assets ($M)	Total deposits ($M)	State	Parent
10/31/1988	Merrill Lynch Bank USA	60,879.30	51,601.10	UT	Merrill Lynch
5/25/1990	Morgan Stanley Bank	27,391.00	19,535.00	UT	Morgan Stanley
3/20/1989	GMAC Bank	23,451.00	10,740.00	UT	Cerberus/GMAC
3/20/1989	American Express Centurion Bank	23,419.50	2,791.50	UT	American Express
9/15/2003	UBS Bank USA	23,090.80	20,222.20	UT	UBS AG
7/6/2004	Goldman Sachs Bank USA	15,028.00	13,341.90	UT	Goldman Sachs
9/24/1984	Fremont Investment & Loan	10,767.50	9,754.40	CA	Fremont General Corporation
4/1/2003	Capmark Bank	6,616.80	4,918.90	UT	Capmark Financial Group/GMAC
9/27/1996	USAA Savings Bank	6,346.30	326.20	NV	USAA Life Company
10/20/2000	Citibank	4,065.60	3,078.70	UT	CIT Group
8/24/2005	Lehman Brothers Commercial Bank	3,431.70	2,849.10	UT	Lehman Brothers Bank FSB
11/12/1999	BMW Bank of North America	2,365.00	1,815.30	UT	BMW Group
2/12/1993	GE Capital Financial, Inc.	2,217.30	214.60	UT	GE (General Electric)
12/16/1991	Advanta Bank Corp.	2,011.40	1,408.20	UT	Advanta
8/2/2004	Beal Savings Bank	1,505.80	62.00	NV	Beal Financial Corporation
10/5/1984	Fireside Bank	1,437.00	1,210.80	CA	Unitrin, Inc.
9/22/1997	Merrick Bank	1,119.00	880.00	UT	CardWorks, LP
6/1/1998	Wright Express Financial Services	1,108.20	927.20	UT	Wright Express
11/28/2005	Sallie Mae Bank	807.30	611.90	UT	Sallie Mae
11/3/1989	Centennial Bank	673.10	524.80	CA	Land America Financial Group

Source: Bovenzi 2007.

Note: Financial data as of June 30, 2007.

Figure 45: Other Notable ILCs

Insured	Institution	Total assets ($M)	Total deposits ($M)	State	Parent
1/10/2002	Volkswagen Bank USA	288.0	239.8	UT	Volkswagen
8/16/2004	Toyota Financial Savings Bank	272.2	68.6	NV	Toyota
8/25/1997	Eaglemark Savings Banks	51.6	4.2	NV	Harley-Davidson
9/27/2004	Target Bank	15.3	6.5	UT	Target Corporation

Source: Bovenzi 2007.

Note: Financial data as of June 30, 2007.

Figure 46: Total Mexican Private and Public Lending by Loan Category: Lending per Capita, 2000–2009

Year	Population	Commercial	Consumer	Housing	Government	FOBAPROA and IPAB3	Total private lending	Total lending
2000	97,966,000	4,795	612	1,977	2,310	4,371	7,383	14,273
2001	98,994,087	4,291	811	1,782	2,200	3,849	6,884	13,183
2002	100,002,340	4,320	1,048	1,666	2,743	3,153	7,034	13,283
2003	101,020,862	4,070	1,471	1,479	2,658	2,652	7,020	12,656
2004	102,049,758	4,627	2,052	1,497	1,997	2,293	8,175	12,988
2005	103,089,133	4,826	3,005	2,002	2,188	610	9,832	13,324
2006	104,221,361	5,811	4,123	2,566	1,830	242	12,500	15,196
2007	105,280,515	7,299	4,934	2,871	1,802	—	15,105	17,790
2008	106,350,434	8,514	4,566	2,987	1,534	—	16,066	18,410
2009	111,211,789	8,409	3,484	2,997	2,196	—	14,889	17,700

Sources: Comisión Nacional Bancaria y de Valores; World Bank, *World Development Indicator*. data.worldbank.org/indicator.

Note: Lending amounts are expressed in millions of 2009 Mexican pesos.

Figure 47: Mexican Credit Card Market: Number of Consumer Accounts by Bank and Bank Market Share (2009)

	Number of cards (Dec. 2009)	Market share
BBVA Bancomer	3,333,985	28.11%
Banamex	3,046,520	25.68%
Santander	2,028,846	17.10%
HSBC	960,666	8.10%
Banorte	705,932	5.95%
BanCoppel	465,267	3.92%
American Express	436,178	3.68%
Banco Inbursa	309,117	2.61%
Scotiabank	289,354	2.44%
Ixe Banco	89,974	0.76%
Banco Invex	66,693	0.56%
Banco Fácil	44,968	0.38%
Globalcard	39,047	0.33%
BNP Paribas (Cetelem)	22,292	0.19%
Banregio	8,543	0.07%
Banco del Bajío	7,931	0.07%
Banco Afirme	5,939	0.05%
System	**11,861,252**	**100.00%**

Source: Banco de México 2009.

1. Nationally chartered banks such as JP Morgan Chase and Bank of America are regulated by the Office of the Comptroller of the Currency (OCC), which is an agency of the U.S. Department of Treasury. Federally chartered credit unions are regulated by the National Credit Union Administration (NCUA). State-chartered banks and ILCs are regulated by the FDIC and state bank regulatory agencies. The most stringent prudential regulatory powers, which entail the supervision of the bank holding company and its corporate parent/subsidiaries, are vested in the OCC in its mandate to ensure the safety and soundness of the national banking system. In comparison, the FDIC authority/enforcement powers are limited to the direct supervision of the bank's operations to the exclusion of its relationship with the parent corporation and its subsidiaries. Nationally chartered banks expressed opposition to Walmart's ILC application due to the much less demanding regulatory requirements imposed by the FDIC versus the OCC.
2. The merchant or interchange fee is divided among the following participants in the credit card transaction process: lending or issuing bank; merchant or acquiring bank; Visa, MasterCard, Discover, American Express transaction network; and transaction clearinghouse processing company.
3. Walmart celebrated the 1,000th MoneyCenter milestone by donating $10,000 to the Community Center of St. Bernard Parish, an area that suffered widespread devastation from Hurricane Katrina, as well as $1,000 to groups promoting financial literacy in Atlanta, Birmingham, Charlotte, Dallas, Houston, Orlando, Phoenix, Raleigh, and St. Louis (Walmart 2010a). These modest donations are consistent with its corporate philanthropic policies that trumpet the positive, local impact of Walmart's activities with small cash donations while deflecting attention from the public subsidies that often are negotiated before opening a new Walmart Supercenter.
4. CompuCredit has been the defendant in several class-action lawsuits regarding deceptive marketing, high account management fees, and abusive collection practices. In December 2008, CompuCredit settled a major federal suit with the FTC. The case, *Federal Trade Commission v. CompuCredit Corporation and Jefferson Capital* (Civil No. 1:08-CV-1976-BBMWRGV) includes violations of the Fair Debt Collection Practices Act (FDCPA), which resulted in a $100M settlement for restitution to CompuCredit credit card customers.

5. The OCC ruled that Santa Barbara Bank & Trust could not originate, purchase, or hold RALs for the 2010 tax season. With the loss of three-fourths of its line of credit for RALs, Jackson Hewitt has been seeking another bank partner without success. It also sought to sell its RAL lending business to a bank holding company so that it could continue to offer the RAL program, but ultimately it was not successful. Some local Jackson Hewitt offices may offer RALs, but they were not available nationally in 2010.
6. The risk-based pricing policies of Walmart's banking partners could be construed as simply reflecting the high delinquency rates of these customers. This assumes, however, the accurate dissemination of information between Walmart customers and its consumer loan providers. That is, Walmart has invested billions of dollars in cultivating customer trust in its low-cost retail merchandise brand and thus would require unrealistic expectations of customers' informed knowledge of their personal creditworthiness as expressed in risk-adjusted finance and fee charges. Since only a limited range of high-cost consumer loans are offered by MoneyCenter partners, while Walmart emphasizes the convenience and low cost of its products, the only way for more creditworthy customers to rationally respond is to not obtain a loan at Walmart. Since there is an increasingly wide range of customers shopping at Walmart and the assumption is that Walmart is the low-cost leader, the MoneyCenters are exploiting the lack of perfect information between customers and loan providers.
7. The national dependence on worker remittances and consumer credit has contributed to a peculiar and seemingly contradictory relationship in some major urban areas: growing unemployment coinciding with rising cost of living. The lack of consumer credit in rural areas tends to statistically attenuate this inflationary pressure in the national aggregate data.
8. The ability of some low-income households to shop in stores that seemingly are beyond their financial means is due to three primary factors: (1) unreported income derived from informal economic activities, (2) access to consumer credit for installment purchases, and (3) remittances from family/friends employed in the United States.
9. During the 1970s and 1980s, the PRI-dominated government primarily financed its exploding public deficits through international borrowing and de facto expropriation of the private banking system. For instance, since the Mexican central bank was not politically independent, the Mexican government pursued a policy of reducing inflation due to spiraling federal

budget deficits by increasing the mandated private bank reserve levels; required reserve rates jumped from 3% in 1959 to 46% in 1979 (International Monetary Fund 2009). Although the Mexican central bank paid interest on these reserves, it was below the rate of inflation (i.e., negative cost of borrowing). Hence, the Mexican government financed its deficits by essentially expropriating nearly half of the deposits in the private banking system (Del Angel-Mobarak 2002). The result was a dramatic contraction in the issuance of private credit.

10. This is a lower bound estimate of the growth of housing lending because it includes only performing loans. Much of the housing portfolio was nonperforming, and the principal value and past-due interest of those loans were continually rolled over into an accounting category called "rediscounts." Inasmuch as the value of rediscounts was nearly equal to the total value of housing loans in December 1994, the threefold increase in housing loans from December 1991 to December 1994 is a lower bound estimate. The actual rate of growth might have been nearly twice that. See Haber (2005a).

11. President Bill Clinton, upon the recommendations of Secretary of Treasury Robert Rubin and FRB Chairman Alan Greenspan, provided $20B in U.S. loan guarantees to the Mexican government through the Exchange Stabilization Fund (ESF). Overall, Mexico received over $50B in loan guarantees, which were repaid early in 1997, including a $500M profit to the U.S. government.

12. The FOBAPROA ("Banking Fund for the Protection of Savings") bank bailout began in 1994 and continued through 2001 with the write-off of final FOBAPROA bonds in 2006. Similar to the U.S. Treasury's 2009 toxic asset purchase program, underperforming loans were transferred from Mexican banks to FOBAPROA. The percentage of bank loan portfolios composed of FOBAPROA bonds jumped from 9% in 1995 to 20% in 1996 and to 29% in 1997 and 1998, and then peaked at 35% in 1999. As of June 1999, the total cost of the bailout programs was Mex$692B (US$65B), almost 15% of Mexican GNP (Murillo 2002).

13. As reported in 2000 pesos, the latter declined from Mex$184,647B in 2002 to Mex$109,840B in 2008 with a steep rise to Mex$164,383B in 2009 (Comisión Nacional Bancaria y de Valores 2009).

14. The lower average and median credit card interest rates reported by Banco de México are due to the large number of 0% introductory or teaser rate offers that comprised 11% of all credit card accounts at the end of 2009.

15. In addition to high interest rates and fees, the cost of using credit cards in Mexico is much higher than using cash, since the Mexican government levies a consumption tax (IVA) of approximately 15% on all purchases except for food, medicine, and other essential items. For the Mexican government, the expansion of consumer credit cards serves two crucial functions during the current economic crisis. First, it increases the purchasing power of lower-income households and thus increases effective demand and macroeconomic growth. Second, credit card issuing banks serve as de facto federal tax collectors by regularly remitting IVA payments to the Mexican treasury.
16. The number of open-loop credit cards includes both primary and secondary card users on the same account. These figures exclude accounts that are closed-loop or proprietary retail cards as well as credit card accounts that are past due. At the end of 2009, there were a total of 11.9 million "current" Visa, MasterCard, and American Express credit card *accounts* that included an additional 10.2 million secondary account users. Hence, a total of 22.1 million credit cards were active at the end of 2009.
17. Exchange rate of Mex$12.80 = US$1 (January 27, 2010).
18. Banco Azteca is a subsidiary of Grupo Elektra, Latin America's largest specialty retailer and Mexico's leading consumer finance company.
19. The author conducted fieldwork in various retail stores including Walmart in June 2008 and July 2009. These reported interest rates were recorded during these research trips.
20. In addition to operational functions, the POS software includes risk management tools for monitoring the performance of loan portfolios as well as multiple tracking features such as the fiscal and accounting information required by Mexican banking authorities (Conger 2003).
21. Prior to reorganizing as a bank holding company, which included the purchase of North Fork Bank and Chevy Chase Bank, Capital One was a nondepository financial institution that relied on raising capital for consumer lending through the packaging of outstanding credit card debt and the securitization of these account revenues through the sale of ABSs. Since the collapse of consumer debt markets in fall 2007, it has been difficult for nondepository financial institutions to raise capital through the securitization of consumer debt and the sale of ABSs. This has substantially raised the cost of funds when the market rate of depository institutions is at record lows.
22. A fourth revenue source is derived from basic, low-cost services such as check cashing, money orders, prepaid debit cards, and

electronic bill payment. These low-margin services are less important in generating net income than in attracting customers to use other high-margin financial services or to increase their merchandise purchases. In the case of Banco Walmart, a fifth source of revenue enhancement is low-yield savings, checking, and investment accounts that indirectly increase financial revenues by reducing the bank's cost of funds and thus increasing the profit margins on consumer loan products. And, by issuing its own credit cards, Banco Walmart reduces the merchant or interchange fees that are incurred during the processing of electronic credit and debit payment transactions. Also, the cost of processing traditional paper checks is reduced by electronic conversion through Banco Walmart.

23. As Banco Walmart proceeds to offer consumer insurance, auto loans, and mortgages, it is likely to develop investment banking–related services for packaging and then selling its consumer loans as ABSs. This is a future revenue source that will emerge when the growth of these consumer loan products achieves a sufficient economy of scale.

24. Due to the nature of Mexican employment laws, millions of workers are essentially self-employed or operate small businesses with family and friends. The so-called informal economy is often larger than the formal economy that operates under government employment, tax, and safety laws and enforcement regulations.

25. It is difficult to estimate the average Banco Walmart credit card interest rate, since the outstanding balances of the closed- and open-loop accounts are not reported separately. But, since the open-loop MasterCard was recently introduced in February 2010, only a small proportion of its credit card accounts qualify for APRs under 60%.

26. Walmart began operating in Canada following the acquisition of the 122-store Woolco division of Woolworth Canada in 1994. Today, Walmart operates over 300 stores across Canada with over 82,000 employees (Walmart Canada 2009).

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