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Better banking in Latin America

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Financial institutions in developing countries have social responsibilities, since financial depth is an important for economic growth.

Corporate social responsibility (CSR) within financial institutions not only concerns internal and external stakeholders but is also linked to their role as financial intermediaries in developing countries, for example in providing microfinance services to individuals and small businesses that would otherwise not have access to such funds.

In developing countries, where lack of financial depth limits economic growth, financial institutions have an opportunity to exercise better practices in social responsibility, aiding in the creation of an efficient financial system that makes saving and borrowing instruments available to most citizens.

Take Latin America, for example, where financial depth can be defined as "low" or "lower" depending on the country. For example, some 18 percent of the population in Ecuador, 55 percent in Colombia and 65 percent in Peru have no access to financial services.

In their paper, "Best Practices in Credit Accessibility and Corporate Social Responsibility in Financial Institutions," IESE's Antonio Argandoña and Francesc Prior-Sanz analyze the lack of financial services in these three emerging markets and propose solutions to tackle the underlying causes.

"Microcredit can be a means for financial institutions to put their CSR into practice," the authors stress, "a way to integrate people in the active population and combat the cause of social and financial exclusion."

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However, the authors argue that in the long term, the microfinance industry needs to be efficient if these goals are to be achieved.

And efficiency is currently a major problem. In analyzing the underlying causes for the flawed system, the authors found that the cost of basic financial services — such as interest rates, minimum balances and charges for transfers or withdrawals — was high compared with those in developed countries. The high prices were found to be related to low efficiency ratios, as well as the fact that the financial industry in these countries is highly concentrated and, as a result, less competitive.

The authors also found that the financial services distribution networks in most Latin American countries were not capillary due to the high costs of traditional branch networks, with only 9.3 bank branches per 100,000 inhabitants in Ecuador, 8.7 in Colombia and 4.2 in Peru in 2004.

Out-of-sync methods of credit risk analysis were also discovered to create additional barriers and inefficiency in the markets analyzed.

So how can lending institutions overcome these hurdles? Drawing on examples of best practices currently being implemented by several key institutions in Latin America, the authors provide us with a starting point.

Best practices in action

Banco de Crédito del Perú, the leading bank in the Peruvian financial system, made strides in providing a low-cost, best-practice product with its Business Solutions Card, a prepaid card offering a revolving line of credit for small businesses. The card, managed by Visanet Peru and also sold in the smaller specialized microfinance institution, Mibanco, works by allowing customers to draw from 1,500 to 52,500 new soles ($500 to $17,000) from any ATM or bank branch without having to provide capital, with an 18-month repayment period. The prepaid aspect allows for real-time authorization and minimizes fraud risk, while the Visanet platform allows people who are not customers of the bank to obtain a card.

Bancolombia, Colombia's leading financial group, addressed the problem of non-capillary networks by creating one of the largest payment systems and branch networks of any private bank in Colombia. The bank targets urban clients through the microfinance segment, while rural clients are addressed through mobile branches. In addition, the bank has a network of 10,000 Convitel dataphone sites in stores, which can be used for balance inquiries, cash

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withdrawals and transfers within Colombia.

The bank hasn't stopped here, and has numerous plans for expanding its network via banking agents, alliances with cooperatives and expanding its microfinance unit.

Banco Solidario, the first Ecuadorian bank to enter the microfinance market, has done its part by developing credit-scoring methods specifically for low-income customers, using best practices and infrastructures. The bank offers microenterprises loans of up to $10,000, increasing by $1,500, $3,000 or $5,000 depending on the customer's payment record. Credit scoring is fast, giving an answer within 48 hours, and is done via branches or the agents' PDA. The bank is also developing a behavioral credit-scoring model that will deliver decisions automatically for increases in credit limits, credit-line renewals or special assessments for existing customers.

The best practices of these banks are just some of the ways that the low level of banking penetration can be overcome in Colombia, Ecuador and Peru. So, do financial institutions in developing countries have any specific social responsibilities? The authors conclude by stressing that the answer is yes — these institutions must be aware of their important social function and key role in alleviating poverty through providing financial services to the unbanked population in their countries.

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