



Digital readiness in financial cooperatives in Latin America & the Caribbean



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1. Introduction

Financial cooperatives (FCs) are one of the most common types of financial institutions in many countries across Latin America and the Caribbean (LAC). They generally serve low- and middle-income segments of the population who live in rural areas and/or are underserved by commercial banks in urban areas. In societies where inequality and the urgent need for economic development are pressing, FCs can be an ally for inclusion and economic growth.

FCs differ from commercial banks in their ownership and governance structure; for FCs the latter is usually characterized by a one-member, one-vote structure. Despite these differences, for commercial banks and FCs alike, digitalization is increasingly important to remain relevant in rapidly growing markets.

Digital transformation—client- and/or process-oriented—is crucial for FCs to remain competitive. While most banks have recognized the value and necessity of digitizing their business and have advanced in their digitalization process, there is a growing digital divide between banks and FCs. The pace and scale of digital transformation (through mobile apps, cloud computing, big data, etc.) may allow banks to enter geographic areas where competition against FCs was previously not viable.





This document summarizes the findings of the study, “Advancing Financial Cooperatives’ Digital Readiness.” This research was commissioned by **IDB Invest** and carried out by **Sparkassen-Finanzgruppe** (Savings Banks Finance Group, of Germany). The aim of the research is to generate knowledge and understanding to promote digital transformation in FCs in order to support their strategic objectives and operational effectiveness. Engaging with ten FCs across the LAC region, Sparkassen-Finanzgruppe designed a **Digital Readiness Assessment (DRA)** to score each FC’s progress in digitalization, identify common challenges experienced by FCs and learn about the solutions some FCs have implemented.

The DRA uses qualitative data to measure the capacity and ability of an FC to adopt, use, benefit from, and develop through digitalization. The methodology applies quantitative analysis to evaluate and rank an FC’s digital readiness based on six components: Infrastructure; Institutional Scope; Digital Development; Security of Operations; Value Proposition; and Challenges and Leadership.

Sparkassen-Finanzgruppe also conducted more in-depth case studies (featured below) of three FCs: the two with the highest DRA’s scores, and one more well-advanced, added to ensure inclusion of a Caribbean perspective. The goal of the case studies is to identify lessons learned and success factors that could inform other FCs on the digitalization process.

¹ Particularly in Barbados, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Guatemala, Honduras, Jamaica, and Mexico.

2. FCs in Context: Why are FCs less advanced than banks in digitalization?

Several characteristics differentiate FCs from other financial intermediaries, particularly commercial banks. For one, **FCs are people-centered**; they focus on providing affordable services that meet the needs of their members. In this context, FCs understand digitalization as a means to better serve their members' needs; not always as an end in itself to optimize their financial performance. Other reasons FCs are less advanced than commercial banks in digitalization services include:



Staffing

Few FCs have invested in developing their human capital to provide their staff with the competencies required for digitalization.



Budgets and costs

Many FCs find it difficult to navigate the economics behind their own digitalization process. The direct and indirect costs that FCs face in their digitalization make their advancement pace different compared to organizations such as commercial banks.



Independence

Most FCs rarely engage in dynamic cooperation and exchanges with other financial organizations and fintech companies, which hinders these institutions from grasping opportunities or accessing digital services at more accessible costs.



Client base

FCs commonly operate in semi-rural and/or semi-urban areas, where markets have different dynamics and characteristics than in urban and developed regions. Some FC members have limited digital skills, due to lack of resources, cost of access to technology, and education levels. Serving younger generations is a challenge accentuated by the costs associated with digitalization.



Regulation

Regulatory conditions and requirements can make it difficult for FCs to operate more competitively in the digital arena.



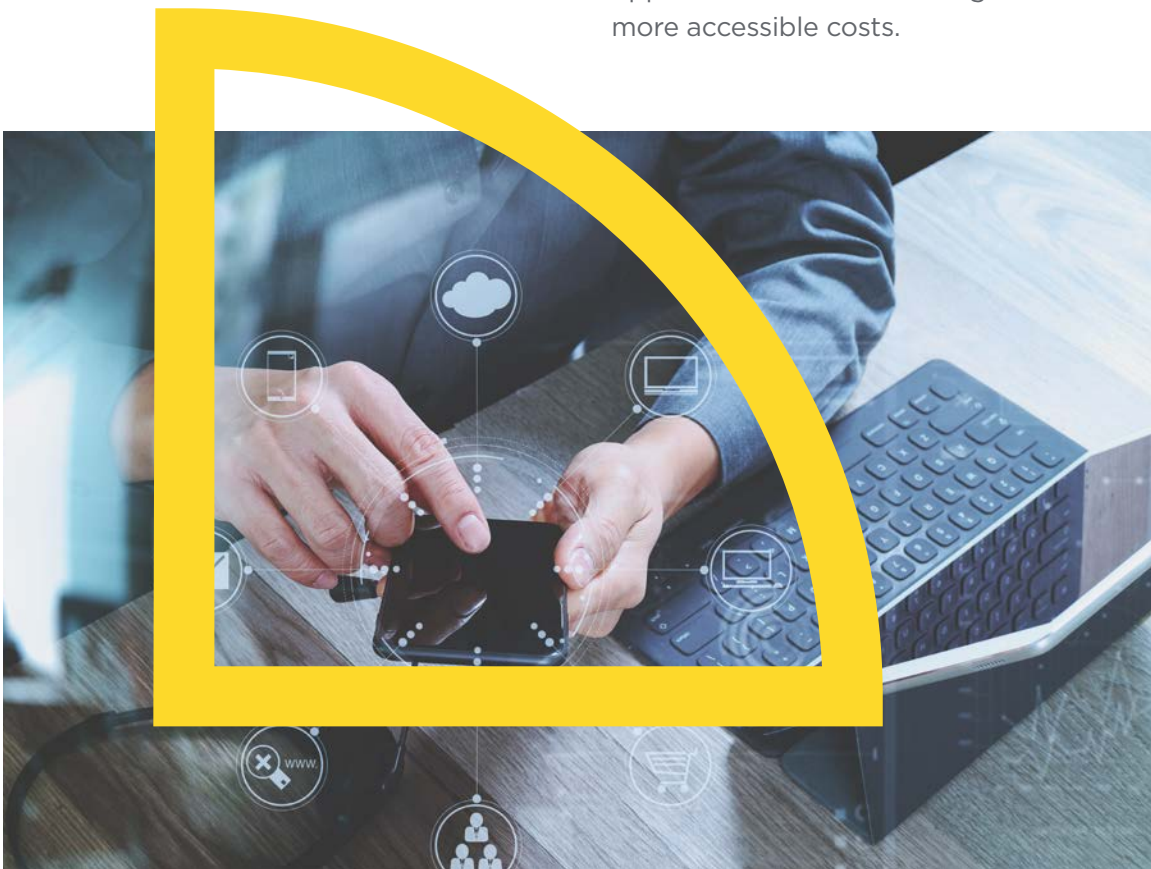
3. Digital readiness in FCs: key takeaways from the DRA

The results delivered by the DRA suggest that digitalization in FCs is relatively more homogeneous when it comes to determinants such as Infrastructure, Security of Operations, and Challenges and Leadership. Homogeneity in these areas implies that digitalization could advance by meeting certain relatively common conditions and requirements, and/or by executing certain relatively uniform procedures and functions.

By contrast, there is more heterogeneity in terms of Institutional Scope, Digital Development, and Value Proposition, implying more complexity to advance in digital readiness in these areas.

Improving Institutional Scope, for example, requires overcoming important internal difficulties in shaping a vision toward digitalization that is supported by all employees. It also requires finding a workforce that is properly skilled for the implementation of such a vision.

Digital Development requires addressing hurdles related to the difficulties of truly understanding the economics behind the digitalization process. Identifying costs and returns, calculating break-even points, and planning for the financial sustainability of digital channels is not easy for most FCs. Furthermore, the collaboration of FCs and fintech startups has not yet developed with third parties, which complicates the process and reduces opportunities to access digitalization at more accessible costs.



Enhancing an FC's Value Proposition to improve member services requires proper, yet frequently mishandled, use of digital channels to collect, identify, and analyze customer needs. It is rare to find FCs using information from digital channels to provide better services. Most FCs are still learning how to leverage information from digital channels, and it is uncommon for them to use this data to assess their members' risk profiles.

The research identified that the most common limitations among the less digitally-advanced FCs include:

- Lack of a digital transformation roadmap; digitalization is not part of an inspirational vision for the organization.
- Virtualization is a pending issue, digital channels are insufficient, and in some cases even the online banking experience is poor.
- Although basic operational security standards exist, there are no firewalls, contingency plans, and/or adequate monitoring, methods, and systems.
- There are challenges related to data management and there is no responsible party for data integrity.
- There are no standardized processes to identify how digital services contribute to overall operations, member experience, or innovation. Data is not used in a timely fashion to satisfy members' needs; and data is not regularly audited.
- Members are not systematically encouraged to use digital services; digital content is not regularly refined; and the user experience is not regularly evaluated.
- There is an absence of well-defined positions and functions within the organization, and of programs to develop employee skills and competencies.
- There is a strong internal resistance to change toward digitalization and leaders lack support to achieve digital transformation.
- There is no dynamic and flexible cooperation with third parties.

By contrast, the most digitally advanced FCs share the following characteristics:

- **An early start to digital transformation.** They began more than ten years ago under a clear rationale to use digitalization as an essential tool to serve their members and/or strengthen their value proposition.
- **Strict principles and standards for innovation.** Specific teams carry out specific actions and the FC fully owns the technology production process, rather than outsourcing it.
- **Strong support from teams and investment in the human capital required for digitalization.** Management is committed to digital transformation and effectively motivates and supports employees to build a broad internal support system for digital transformation.
- **Customers are encouraged to use digital channels.** Information from this process is monitored and evaluated on a regular basis and timely action is taken to innovate.
- **Regular monitoring of markets and the external environment.** This information is used to seize opportunities and reduce risks.
- **An open approach to exchange, alliances, and cooperation with third parties.** FCs are ready to learn from and cooperate with third parties as a tool to reduce the costs of digitalization.



The most advanced FCs' progress in terms of digital readiness can be explained by i) external factors, ii) strategic decisions, iii) tactical decisions, and iv) organizational values.

External factors, such as greater urbanization, change in members' demographics, and new generations more familiar with technology, make digital advancements necessary. Other external factors, such as increased competition, incentivize FCs to differentiate their products and, thus, to use digitalization as a strategic tool to connect with members. Regulatory matters can also help bring momentum to digitalization efforts.

The more digitally advanced FCs adopt strategic decisions that often do not only adhere to established standards but, instead, aim to exceed them. Rather than outsourcing important developments, these FCs aim to meet their objectives while leveraging the skills of each individual employee for the benefit of the organization. And, they understand and meet their members' needs to determine specific technology requirements.



Tactical decisions in the more digitally-advanced FCs involve:

- Decision-making and support from leaders to foster innovation
- Providing feedback and meaningful rewards to employees to incentivize and motivate them
- Developing employees' internal competencies (e.g., team building skills, emotional intelligence, IT, and analytical program skills)
- Filling crucial internal positions with existing staff
- Openness to collaboration with technology providers, fintech companies, startups, universities and other actors to, for example, cope with the considerable financial resources and specific set of skills required by digital development

Finally, organizational values common in the more digitally-advanced FCs **include a sound social approach, strong emphasis on human development, and a cautious approach** from a solid foundation to digital readiness.

The social approach is one of the most important value-adds that FCs have. The image and prestige that these institutions have in their communities creates a virtuous circle that generates incentives within the workforce to keep up efforts to maintain the prestige. **The more digitally-advanced FCs share a social approach and keep humans at the center of the whole operation.** Technology for them is not an end in itself, but a means and tool to increase efficiency for their members.



4. Case studies: three FCs in Latin America and the Caribbean

This section expands on the reasons behind the relative success of **Financiera Comultrasan** (“Comultrasan,” based in Colombia) and **Cooperativa de Ahorro y Crédito Jardín Azuayo** (“Jardín Azuayo,” of Ecuador), all regional leaders in DRA.

This information is contrasted with data for **First Heritage Co-operative Credit Union Limited** (“FHC,” based in Jamaica). Although it trails in the DRA, it constitutes an interesting reference point about digital transformation in the Caribbean.

Comultrasan



Comultrasan began its shift toward digitalization in 2009. The main challenges it faced at the start of the process included a lack of specialized personnel and adequate methods to innovate. To tackle this, Comultrasan established an innovation team specifically dedicated to identify clients’ needs and provide timely solutions at high standards.

The innovation team has institutionalized a process that includes the use of financial models to establish costs, funding sources, and potential income (although revenue is not a priority over customer satisfaction).

Comultrasan’s organizational culture—characterized by openness, competitiveness, a solid scheme of incentives (monetary and non-monetary), personal development, and focus on results with a social approach—has been key to building a robust workforce to support digitalization efforts.

This FC has seized the existence of regulation to enhance digitalization. Although **Comultrasan** follows the regulatory requirements enforced by Supersolidaria (the supervisory agency for FCs), it decided to explore adopting some of the stricter standards from Superfinanciera (the banking supervisor). As a result, long-term planning is stronger and there have been improvements in areas such as credit risk and data protection. The adoption of ISO certifications, the appointment of an Information Security Officer, and the creation of a disaster recovery plan have reinforced the credit risk and data protection process.

Comultrasan evaluates its digital infrastructure periodically (every three years). If they notice a 10% opportunity for improvement (that is a measurement criterion that they have), they undertake the necessary changes to avoid any possible risk of running their operations with an outdated infrastructure.

Members of senior management regularly take part in international trips to broaden their perspectives and exchange ideas. Management is open to networking, exchange, alliances, and cooperation with third parties. One such alliance resulted in the creation of Shareppy, a fintech that helps **Comultrasan** expedite credit allocation, as well as improve banking mobility and portfolio management.

This FC is introducing innovative digital solutions to address market changes brought about by increased urbanization and younger generations: at present, 82% of **Comultrasan's** members live in urban areas, 18% are 25 to 35 years old, and over a third are independent of the cooperative (not employed by Comultrasan).

Comultrasan fosters members' use of digital channels by informing them about the benefits and advantages of doing so, improving content, and facilitating utilization. Data is analyzed daily, evaluated monthly, and readjusted quarterly to determine the preferences and behavior of members and, ultimately, add greater value.

An important innovation at **Comultrasan** was the creation of a service through which employees go to the domiciles of members who would like to open savings accounts and/or make cash deposits from the comfort of their homes instead of using branches or online services. This initiative received an IDB innovation award in 2012.





Jardín Azuayo

Innovation has been at the core of **Jardín Azuayo** since it was established in 1996. Technology is conceived as a primary tool to serve its members under a vision of cooperativism (continuous action to build a collective identity, develop social capital through the democratic participation of the community, and channel resources to people who need them).

Both responsibility and austerity are behind this FC's decision in favor of using technology to meet its members' needs or to improve the costs and quality of its services. **Jardín Azuayo** has extensively developed its plan and route to manage digital transformation. This FC periodically (every four to five years) structures an institutional strategic plan that establishes investments, including virtualization and infrastructure.

Historically, **Jardín Azuayo** has developed technological tools to improve its value offer. For example, when internet access was not available in rural areas or was too expensive, it created its own radiofrequency network. By 2005, this FC owned the most extensive physical telecommunications network in Ecuador, with its own telephone network, intranet, internet access from all its offices, digitized documents, online transactions, etc.

This FC also developed its own core banking system, which gives it full control over the operational process. Long ago, **Jardín Azuayo** decided to have control of its technological production, rather than delegating it to third parties. The firm estimates that its tactics to develop economies of scale in this area would require investments over US\$400 million today.

The fact that **Jardín Azuayo** has many members receiving remittances from the US and Europe has become an additional incentive for continued digital transformation. This is because this segment of members is more inclined to use services through digital channels and, in some cases, also more skilled at doing so.



This FC has established clear procedures around technological services, with clearly assigned responsibilities to monitor and manage data, test and maintain systems, and support distribution channels for services. There is a budget specifically intended for digitalization and almost 12% of its total workforce is exclusively dedicated to the technological area. Investments in software and technology production are channeled into employees' training and skill development, and into building economies of scale.

According to management, the regulatory framework is at times in conflict with **Jardín Azuayo's** cooperativism and appears more suitable to entities that seek profit-maximization as chief priority. Despite this, **Jardín Azuayo** has shown flexibility to adapt, without modifying its vision.

The commitment and skills of the workforce have helped significantly to said adaptation process and, more generally, to implement overall digitalization objectives. Training and education of the workforce are key to **Jardín Azuayo's** governance.

To improve its value offer, not only through digital development, Jardín Azuayo brings education and training to its members. This FC does not use marketing strategies, but word-of-mouth communication as a popular literacy strategy to promote cooperative values.



FHC

FHC operates in a highly competitive environment in which members are chiefly focused on obtaining higher returns and are usually affiliated to two or more FCs. As such, FHC is forced to constantly increase efficiency and provide the right solutions to members to remain competitive.

This FC is in the process of building a culture of commitment and services. Its service approach is reflected in efforts such as increasing members' financial education and providing them with basic legal advice to strengthen their potential to develop their own businesses.

Digitalization efforts are being implemented in the aftermath of a merger that took place six years ago, a change in the board of directors three years ago, the recent appointment of a new CEO, and ongoing decisions around a new core banking platform.

The latter is, by far, the most challenging ongoing project. The platform change was triggered by obsolescence (the current platform is 15 years old), the indirect effect of regulatory changes, and the need to improve interoperability to achieve new business opportunities. The process requires considerable effort to maintain the security of operations and to that end, a new head of IT was appointed to manage the process.



Management is supporting digital transformation with firm leadership, flexibility, and an open attitude. The new CEO's leadership style, based on kindness, motivation, and open and continuous communication, has improved internal dialogue and support for the digital transformation process.

The CEO is highly driven toward growth and innovation, and closely follows the market to understand the needs and economic situations of **FHC** members, changes in demographics and regulation, and even what the competition is doing.

Around 74% of **FHC's** employees are women, including the CEO. The combination of a deliberate focus on merit, kindness, and gratitude with a largely female workforce and the observed progress in digitalization is worth mentioning because these elements make it possible to improve performance and take advantage of digital transformation, despite limited resources.

FHC is advancing some digitalization efforts with cooperation from third parties. It is currently working with a fintech to gain insights and leads from digital channels.

Input from **FHC's** clients, received through digital channels, its call center, or its branches, is analyzed and processed to improve operations and services. However, further digitalization is somewhat hampered by limited financial literacy and technological skills in the market, as well as the need to better train FHC personnel.



5. Conclusions and recommendations

Digital readiness in some of the most advanced FCs is driven by a number of factors, including:

- The definition of detailed plans and standards by committed management.
- Clear delegation of responsibilities and the construction of broad internal consensus to adopt change inspired by management and leaders.
- Employee training and promotion (through monetary and non-monetary mechanisms), as well as plans to ensure that digital transformation does not displace workers.
- Full control over the innovation process, including no outsourcing of key processes.
- Strong data analytics and fluid feedback from customers to adopt innovation in a timely and effective fashion.
- An appropriate systems and information security infrastructure.
- Networking and alliances to improve information exchange and counterbalance the costs and training of adopting digitalization.



Based on the experiences of the FCs more advanced in digital readiness, the research summarized in this document comprises a series of recommendations to enhance the digitalization process, including:

- Use dynamic interaction with other FCs, financial institutions, and IT and digital service providers as a tool to increase experience and knowledge in digitalization.
- After the above is completed, structure a shared message based on the evidence gathered and related to the social value of FC activities. Communicate this message widely to key stakeholders: members, regulators, research centers, universities, etc. Engage stakeholders as strategic partners in this process.

- Develop a sound strategy to promote coordination, communication, and cooperation among FCs, and between FCs and the academy, in order to generate knowledge and methods to support the value that FCs add to society.
- A “lab” for FCs could use information to produce data science for product development and experimentation with innovative technologies.
- A program to allow expert exchanges and internships between different FCs and research centers could support the development of digital technologies. Other programs can support talent and leadership training.
- By accessing more financial resources, FCs may be able to do more in digitalization. However, financial support must be flexible enough and/or adequately designed for FCs to take full advantage of it. Sometimes, access to experts who provide training, assistance, advisory, and help is even more important than financial resources alone.
- A fund could be established to increase product portfolio and develop innovative solutions. This will help to improve the value proposition of digitalization.
- Technical assistance strategies should focus on improving the credibility and quality of service delivery, strengthening market position and scope of services, and improving other elements of the environment surrounding FCs, such as communication and dialogue with third parties.
- Governments and regulators could make digitalization in FCs swifter and potentially less expensive by supporting financing, advisory, training, product development and experimentation, financial and digital literacy, connectivity, and payments infrastructure.



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