

# ICT Helping to Scale up Microfinance: The Case of a Successful Bank- MFI Partnership in Brazil

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## ABSTRACT

*Finding ways to downscale microfinance is one of the current challenges facing commercial banks, especially in developing countries. As banks have a poor knowledge of microfinance, operating in this market will require capacity-building, innovative business models and new technological architectures. This paper discusses how one particular architecture – the Brazilian model of correspondent banking (CB) – is helping banks cope with these challenges. Since the model was created, in 2000, it has allowed banks to downscale financial services outside their traditional branches and establish successful partnerships with local microfinance institutions (MFIs). The authors focus on one particular case involving a partnership between an accredited MFI (Banco Palmas) and two major banks (Banco do Brasil e Caixa Econômica Federal), to make the argument that the Brazilian CB model represents an innovation at the “meso level”, defined by Helms (2006) as the infrastructure comprising a network of service providers necessary to the operation of MFIs.*

*Keywords: Branchless Banking, Correspondent Banking, Information and Communication Technology (ICT), Microcredit, Microfinance, Microfinance Institutions (MFI)*

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## INTRODUCTION

Microfinance has been considered a powerful instrument to fight poverty and create opportunities for low-income individuals, especially

in developing countries. Even more important to consider is that its effects are not restricted to the individual level, since the increased access to goods and services, promoted through microfinance, will typically influence the whole

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business chain and transfer economic impacts to whole communities (Isangula, 2012).

Over the last few decades, the concept of microfinance has evolved from solely offering microcredit to including other poor-oriented services. Despite being, in its origins, mainly related to NGOs (non-governmental organizations) and government-sponsored and donor-driven initiatives, the microfinance sector has also witnessed the growing involvement of private investors since the 1990s (Daley-Harris, 2009), as a result of which a more relevant participation from the mainstream financial sector has been claimed (Littlefield et al., 2006; Young, 2009). Indeed, the interest of commercial banks in microfinance has led these institutions to create new microfinance delivery models, operating either directly within their own business units or through partnerships with dedicated microfinance institutions (MFIs). In any case, the question that remains is the role that information and communication technologies (ICT) can play in the process (Kauffman & Riggins 2012).

In Brazil, commercial banks increasingly consider including microfinance in their business strategies, especially since the introduction of government incentives. Nonetheless, microcredit penetration in Brazil remains particularly low: no more than 2-4 percent of the country's estimated 19 million micro businesses (formal and informal) have access to microcredit (Nichter et al., 2002; Feltrim et al., 2009). A major factor contributing to such a disappointing performance is a problem that is not specific to Brazil: the stakeholders' limited understanding of the how to use ICT as a key component of the infrastructure needed to help microfinance gain scale.

The research question guiding the study is: *How can an ICT-based platform – like the Brazilian CB model – help to scale up microfinance operations through the partnership of commercial banks and local MFIs?* We present the case of Banco Palmas, revealing how this local MFI successfully built an innovative partnership with two major commercial banks and, thus, significantly improved the offer of

microfinance in a poor neighbourhood. As our results suggest, the lessons produced from this case uncover an innovative alternative for banks and MFIs in other countries and contexts, inviting them to pay more attention to the role that ICT-based platforms might play as a bridge that helps their partnership succeed and their microfinance activities improve.

## LITERATURE BACKGROUND

### ICT and Microfinance

The growing penetration of ICT in the financial services industry over recent decades is a well-documented reality. Nevertheless, different types of financial providers have not achieved the same increases in productivity and business performance following their investments in ICT. Investment banks and insurance companies, for instance, have generally invested fruitfully in ICT whereas retail banks have not fared so well (Castello & Danel, 2006). The retail banking segment actually illustrates relatively well an ICT productivity paradox as it faces the consequences of more and more affordable banking technology coupled with a broad erosion of barriers to entering the banking business.

Without disregarding the differences between MFIs and mainstream financial service providers, the statements above are arguably transposable to microfinance. As we know, banking activities are related to efficiency in resource allocation. Besides the traditional question of how commercial banks will enter the microfinance market, one may ask how they can develop appropriate approaches to serve this market. Indeed, to meet a poor population's financial needs, banks must go beyond offering cheap electronic transactional services (e.g., bill payment, benefits withdrawal). Although their interest in microfinance is reportedly growing (Alves & Soares 2006; Latifee 2006), banks need proper technologies and methodologies to profitably offer financial services to the poor.

Helms (2006) proposes a model based on three levels to analyse the necessary infrastructure for an inclusive financial system: *macro*,

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