Executive Summary

MFI Digitization in Central America's Northern Triangle: The Impact of the Covid-19 Pandemic

By EA Consultants and FAI | January 31, 2023

Defying dire predictions from experts at the start of the pandemic[1], microfinance institutions in the Northern Triangle region of Central America showed great resilience through the challenges of the Covid-19 pandemic. Despite their relatively small scale—or perhaps because of it—the MFIs studied maintained stable profitability, have mostly grown since the pandemic, and have proven very adaptable to digital change.

About the Study

EA Consultants was commissioned by the Financial Access Initiative at NYU-Wagner, with funding from the Mastercard Center for Inclusive Growth, to assess microfinance sector digitization in the "Northern Triangle" of Central America in the aftermath of the Covid-19 pandemic. **Download the full report at www.financialaccess.org/publications**.

Scope and Methodology

To give as complete a picture as possible, the EA Consultants team studied digitization among a broad range of MFIs in terms of size, target market and structure, in addition to the diverse regulatory structures and national contexts in the region (the study included El Salvador, Guatemala, Honduras and Nicaragua). We defined digitization broadly, as changing analog processes into digital ones, including through front office software and apps, tech-driven back-office process efficiencies, and upgrades to core systems and hardware. Between March and July 2022, EA Consultants collaborated with REDCAMIF, the regional microfinance network in Central America and the Caribbean, to survey 41 MFI managers, representing about 82% of the USD 1.77 billion combined portfolio of REDCAMIF-affiliated MFIs in the region. We additionally held in-depth interviews with 12 managers and conducted focus groups and individual interviews with a small subset of loan officers and clients in each country.

[1] https://www.cgap.org/blog/covid-19-how-does-microfinance-weather-coming-storm

Findings

In general, there is a global sense that the Covid-19 pandemic accelerated digitization. However, digitization requires significant funds, and return on investment relies on the promise of scale. As smaller countries with (relatively) small microfinance institutions in a part of the world where donors have had limited presence, the countries in the study lacked both. Nonetheless, Over 80% of surveyed MFIs claim to have made significant changes related to digitization—the majority in back-office systems and processes, as well as software and apps for front-office staff and agents to ensure that clients could continue to be served remotely.

Digital Changes Implemented During the Pandemic (N= 41 MFIs)	
Core Banking/ Hardware	54%
Front Office for Clients	66%
Front Office for Staff	71%
Back Office	78%

An analysis of MFI performance data reported to REDCAMIF by these same MFIs from 2019 to 2021 shows that they cut costs by closing branches and streamlining back-office processes, which led to improvements in operational efficiencies in Nicaragua and Honduras. In El Salvador and Honduras, changes also contributed to an increase in the size of loan portfolios. These benefits likely helped keep Honduran MFIs afloat, and led to increased profitability in Guatemalan, Salvadoran and Nicaraguan MFIs.

Enabling Factors

The success of digitization processes was attributable to a few factors, first and foremost the availability of local expertise. MFIs were able to source in-house staff and local consultants. Local staff were able to design new tools or integrate existing tools from the market such as Cartera Digital and Tigo Money, into the MFIs systems. As in many countries, these new apps and software were layered onto existing third-party tools such as WhatsApp and chatbot features integrated into existing platforms to reach clients and manage MFI staff remotely. These solutions were cost-effective, allowing 27 of 31 MFIs that made any digital investments to fund these either completely or partially with internal funds, while only 6 used donated funds.

Of the investments we observed, MFIs in the region primarily focused on front office support for agents and staff to gain access to clients as a response to lockdowns during the pandemic. As a second priority, they invested in upgrades to back-office processes and technology. This enabled remote loan origination, disbursement and collection, and remote contact with agents, staff, and clients, increasing productivity. Client-facing digital solutions were also tested but have shown little traction. MFI managers believe that this is because clients are unfamiliar and unready to use technology in lieu of in-person service (even virtual personal service). Our understanding of microfinance clients in other regions, combined with our interviews with clients, corroborates this interpretation.

While fintech apps and online banking were not quickly adopted in this region, existing remote infrastructure served as an important bridge for clients during the pandemic. Clients were served primarily through contact with non-bank correspondents/agents, as well as remote and physical visits from loan officers. ATMs were also used, albeit less commonly. MFI sector investments in agent networks and ATMs prior to the pandemic paid off.

A New Digital Divide

Despite the agility and creativity of many MFIs in the region, our study also highlights a new digital divide. Of the 31 MFIs that made significant digital changes, 14 would not repeat them because of limited budgets, poor sequencing and selection errors. Larger institutions and those part of global networks (e.g. Vision Fund) were better positioned over smaller ones in the development of digital solutions. Critically, many of these organizations had already begun developing strategies to digitize: the pandemic merely accelerated what were well-thought-out plans. Additionally, they had more robust systems or were able to invest in them. New apps and software rely on solid back office and core systems to function. Many smaller institutions were not able to invest in these upgrades but rather focused on solving immediate needs such as providing loan officers with short-term tools to manage clients and approve loans. Bugs in their applications, and complaints from loan officers (the main users of the new technologies) ensued.

Left to their own devices, smaller MFIs may not be able to keep up with the requirements of increasing digitization in the region. The long-term effects of falling behind are unclear but there is reason to be concerned if only the largest or most connected MFIs can effectively digitize and maintain operations. Small and medium-sized MFIs, including cooperatives, have been critical to the inclusive financial sector ecosystem in sparsely populated regions, along borders, and in hard-to-reach territories where the cost of accessing remote households is high. Their role is not only critical in terms of deepening financial inclusion. They are more likely to reach and employ women and reach rural households. They can become essential when political and climate disasters strike, offering a lifeline to marginalized customers who have limited access to public services. Smaller and medium-sized MFIs are also offering more ancillary (and high-touch) services including health education, agricultural extension services and financial education.

Outreach and Inclusion Indicators by MFI Size

	Small MFIs	Medium MFIs	Large MFIs
Average loan size	USD 672	USD 965	USD 1856
Rural clients	0.610	0.461	0.538
Women clients	0.714	0.709	0.590
Women employees	0.544	0.477	0.414
Women loan officers	0.370	0.278	0.171

Ways Forward

Funders and investors can preserve and strengthen the critical role of small and medium MFIs in the region by accelerating digital adoption and minimizing potentially unsustainable costs of investing in technology while allowing these MFIs to focus on what they do best—providing trusted hybrid financial services to remote and vulnerable clients.

For Funders and Investors

- Adopt a lens for investment that overturns standard thinking in the digital realm: focus not only on who can serve clients for the lowest per capita cost, but also on who gets served. It is more costly, but still vital, for MFIs to reach those who are currently the least digitized—including women, rural, remote populations. Specifically, funders should pay special attention to small MFIs who exist to serve these populations, but can't amortize the large up-front costs of investing in digitization.
- Invest in core banking systems. Core IT infrastructure among small and medium MFIs is outdated and rickety—and notoriously hard to raise money for. Without support for modernization of this fundamental infrastructure, however, money invested in fintech and innovations will be wasted.
- Provide strategic planning and advisory services to support MFIs in creating digital strategies that effectively sequence digital initiatives and guide them on digital provider selection, negotiation and pricing.

For MFIs

- Create different strategies to acquire customers who are at different stages of digital readiness, including "teaching digital" and a combination of "tech and touch" for the most excluded. Apply similar tiered thinking to the training of MFI staff, who will also have varying levels of confidence with technology and digital readiness.
- Globally, the pathway into digital for many clients has been through small, frequent transactions. MFIs should develop a product roadmap that begins with payments, including remittances, as a way to entice new customers to use digital for loan repayment.

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