
Colombia
Ecuador
Peru

SOLVING *the Access* PROBLEM

By Francisco Prior Sanz

The level of financial deepening in Latin America is either low or very low, depending on the country and the indicator used. In the cases of Colombia, Ecuador, and Peru, the percentage of the population without access to basic financial services is 55 percent in Colombia, 66 percent in Ecuador, and 65 percent in Peru.[1] In contrast, in the developed countries of Spain and the United States only 2 percent and 10 percent, respectively, of the population over eighteen years of age lack access to financial services.[2] Nevertheless, in regional terms, Colombia, Ecuador, and Peru have medium levels of access to financial services; these levels are higher than those in Mexico and Central America (Honduras, Guatemala, El Salvador) but lower than those of Brazil and Chile.

Macroeconomic indicators of financial deepening show similar statistics among those of the population with no access to financial services. In 2003, the percentage of credit to the private sector with respect to gross domestic product was 23.4 percent, 19.9 percent, and 20.8 percent for Colombia, Ecuador, and Peru, respectively. Although these figures are average in Latin America, they are very much below the average of developed countries.

In our research, we analyzed the problem of low access to financial services in Colombia, Ecuador, and Peru, and we propose technical solutions to address the causes of this problem. These solutions, which are already in use by some financial institutions in developing countries, allow banks to profitably service low income segments of the population.

The research in these three Andean countries shows that leading microfinance institutions in these countries have been able to solve this supply problem. The best practices observed are based on the development of financial service distribution business models that are highly efficient. These models combine products, distribution networks, and risk methodologies that allow the profitable servicing of low income population segments.

Causes of Low Access

The analysis of the elements in the supply of financial services explains

Table 1: **Financial Deepening in Colombia, Ecuador, and Peru—Regional and Global Comparisons**

	Private sector credit/GDP		Liquid liabilities/GDP		Capital markets/GDP	
(%)GDP	1990	2003	1990	2003	1990	2003
Colombia	30.8	23.4	29.8	32	3.5	18.1
Ecuador	13.6	19.9	21.1	21.7	0.6	7.9
Peru	11.8	20.8	24.8	29.8	3.1	26.5
Venezuela	25.4	8.6	38.8	22.3	17.2	4.5
Mexico	17.5	18.5	22.4	29.1	12.4	19.6
Brazil	38.9	34.6	26.4	30	3.6	47.6
Chile	47.2	63.3	40.8	38.2	44.9	119.2
Developed countries average	125.8	158.3	92.8	104.3	51.6	100.1
Average income	43	64.2	42.2	81.4	19.4	44.5
Low-middle income	39.3	58.6	41.1	76.9	18.8	43.5
Low income	22.3	27	36.2	51.9	10.5	37.3

Source: World Development Indicators 2003

the inefficiency and inadequacy of the distribution models in Colombia, Ecuador, and Peru. This section looks at five elements that set the context for the financial system: (1) the cost levels of basic financial services, (2) the density of the financial service distribution networks, (3) risk analysis methodologies, (4) database analysis systems, and (5) the regulatory context.

In these countries, the prices of interest rates, minimum balances, maintenance fees and commissions for cash transfers, and withdrawals are very high compared to those of more developed countries. The high prices in Colombia, Ecuador, and Peru are caused not only by the low efficiency rates for the financial institutions but also by the high concentration in these countries' financial sectors.

Financial service distribution networks are not dense enough in most of Latin America because traditional banking networks are too expensive if they are to serve low income clients. As of 2004, there were only 8.7 bank branches per every 100,000 people in Colombia, 9.3 in Ecuador, and 4.2 in Peru.

Credit risk analysis methodologies in the Andean countries, and Latin America in general, are not well adapted to their economic realities; in particular, they neglect the importance of their large informal economies. Current methodologies use stable and proven cash flows (e.g., wage income), excluding income from the informal economy as a determinant of credit worthiness. Moreover, banks concentrate on offering credit to current members by placing a greater weight on variables that tie the client to the institution. Nevertheless, these methodologies rarely include sociodemographic variables that would generate more accurate client profiles and determine credit worthiness faster and cheaper.

There are also problems related to the legal acceptance or recognition of certain kinds of collateral, as well as the information received by credit grantors, which comes almost exclusively from financial institutions. By not including the payment history with commercial establishments of outside customers in their credit profile, banks are in fact being overly restrictive by denying them access to the formal financial system.

From a regulatory perspective, the normative context creates additional barriers to financial services access. In the three countries analyzed, there are different regulatory realities that have different ways of impacting the already inefficient cost structures of financial institutions. Financial institutions in Ecuador and Peru, however, enjoy a more favorable and adequate regulatory context to promote access to financial services than in Colombia.

While there are no controls over the interest rate in Ecuador and Peru because service fees are liberalized, the interest rate in Colombia is limited by the usury rate. Colombia

also taxes financial transactions and forces investments in unprofitable activities, which add costs to financial institutions and, in turn, are reflected in higher prices to Colombian clients for financial services.

In terms of credit portfolio provisions, current legislation penalizes the generation of microcredit loans in the three countries studied. Their regulatory systems force financial institutions to provide this portfolio more restrictively than the other credit portfolios even though delinquency rates are not particularly higher. In the Colombian and Peruvian cases, the definition of the system of guarantees does not fit the economic reality in these countries, further complicating credit granting to the population that operates in the informal economy.

In terms of control and requirements of the distribution network, the Ecuadorian and Peruvian systems are more flexible than the Colombian system. Because of their regulatory flexibility, auxiliary financial service networks were created in Ecuador, and teller representatives were implemented in Peru. These solutions partially solve the problem of lack of access to banking agencies. Although Colombian legislation is traditionally more strict in this regard, it has recently become more flexible with the passing of the law of nonbanking representatives, which aims to add bank branches in the country. Finally, because of illegal activities related to drug trafficking, regulation on international transfers, and information requirements on the owners of banking products, it is difficult to access financial services in general. These requirements do not exist in either Ecuador or Peru, indicating a less strict environment in these countries.

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Table 2: **Main Countries in Latin America That Received Workers Remittances in 2005**

2005	Millions US$	%GDP
Mexico	20,034	2.80%
Brazil	6,411	1.10%
Colombia	4,126	4.10%
Guatemala	2,993	9.30%
El Salvador	2,830	17.10%
Dominican Republic	2,682	9.10%
Peru	2,495	3.20%
Ecuador	2,005	6.40%
Honduras	1,763	21.20%
Jamaica	1,651	19%

Source: The Multilateral Investment Fund, http://www.iadb.org/mif, 2006

Nevertheless, in terms of public policy, the Colombian government has pushed a new initiative called Bank of Opportunities—or Banca de las Oportunidades—that would allow microfinance institutions to generate economies of scale. Enabling the achievement of or access to scale economies is necessary to apply best practices in banking and to optimize migrant remittances because these require infrastructures too expensive to be developed individually by most microfinance organizations. There are no policies in Ecuador or Peru that address this problem from the supply side; in these countries, the only initiative is to create central associations of cooperatives (FINANCOOP in Ecuador and FENACREP in Peru) that seek to create synergies and scale economies. The Bank of Opportunities initiative in Colombia also aims to reduce the above mentioned regulatory obstacles, allowing the possibility to resolve these restrictions in short or medium terms.

Economic and Financial Structures

The macroeconomic context in the three Andean countries has been favorable in recent years. Even after passing through severe economic and financial crises at the end of the 1990s, Colombia, Ecuador, and Peru have all retaken the growth path within a stable macroeconomic situation in terms of inflation, exchange rate, and interest rate. Despite the economic growth in the past years, the population living in poverty has not decreased noticeably. Poverty is one of the structural problems common to the three countries and the whole region.

The 1998 banking and financial crises in Colombia and Peru, and in Ecuador in 1999, forced the countries' governments to intervene to rescue their insolvent banking systems. As of December 2005, the rescue packages had increased public debt levels to 46.8 percent of GDP in Colombia, 40.1 percent of GDP in Ecuador, and 39.7 percent of GDP in Peru.[3] The importance of public debt as a percentage of GDP is another common characteristic in Latin America; this debt generates a steady flow of income to the financial system and does not foster lending to the private sector.

Public debt in Colombia, Ecuador, and Peru shifts the liquidity in the banking system away from the private sector. Servicing the public sector has fewer operational costs and produces higher returns on assets to institutions with inefficient cost structures. This explains why financing in the private sector is concentrated on large corporations, leaving out small enterprises and individual clients.

The financial institution industry in these countries obtains financing from considerable levels of unremunerated deposits. These deposits mainly finance public and corporate credit, yielding high profits and low delinquency rates without having to invest in the infrastructure to bank the rest of the population in the country. The Ecuadorian case shows the striking characteristic of a decreasing delinquency rate even though it is still above the Latin American average, in part due to the persistent effects of the 1999 banking crisis.

Along with the inefficiency of their financial service distribution business models, the macroeconomic structures in Latin American countries explain why financial institutions have not directed their supply of services to low income segments. The scarcity of microfinance services in a context of increasing demand favored the emergence of specialized institutions that serve the financial needs of the low income segments. The increasing demand for their services and the implementation of best practices made it possible for these institutions to obtain high profits and reinvest their earnings to expand their activities. This is the case of Banco Caja Social in Colombia, Banco Solidario in Ecuador, and Mibanco in Peru, all leading banking institutions in the microfinance sector.

Cooperative systems in the three countries, traditionally more likely to service low income segments, were severely affected because of managerial inadequacy and failings during the banking crises. The Colombian case is particularly relevant since the cooperative sector represented almost 10 percent of domestic savings before the crisis, while today it retains only marginal weight in the financial and microfinance sector.

Table 3: **Best Practices in Microfinance Business Models Found in Colombia, Ecuador, and Peru**

Best Practice	ECUADOR	PERU	COLOMBIA
Use of low cost financial products	PICHINCHA	BANCO DE CRÉDITO/ MIBANCO	BANCO CAJA SOCIAL
Commercialization through alternative channels	PICHINCHA	INTERBANK	BANCOLOMBIA
Development of efficient risk analysis methodologies	BANCO SOLIDARIO	MIBANCO	BANCOLOMBIA
Optimization of the impact of remittances	BANCO SOLIDARIO	BANCO DE CRÉDITO	BANCOLOMBIA
Generation of economies of scale	PICHINCHA	CAJAS	BANCA OPORTUNIDADES

Institutions specialized in consumer financing, following business models that were successful in Chile, moved into the niches neglected by banks in the three Andean countries. These institutions can take deposits and at the same time offer consumer credit through electronic banking products distributed by nonbanking networks, primarily retail stores and shopping centers. Though not yet very important, a few consumer finance institutions have begun to gain significant market shares in the microcredit sectors in Colombia (Finamerica, Compartir), Ecuador (Unibanco, Centromundo), and Peru (Financiera Cordillera).

Other factors have also driven the entry of leading banking institutions in Colombia, Ecuador, and Peru into the microfinance market. First, the macroeconomic stabilization in these countries has decreased the financing needs of the public sector. Second, the development of low-cost banking technologies and techniques has enabled the development of business models that profitably serve the needs of the low income segments of the population.

Received Remittances

Remittances from emigrant workers received in Latin America reached US$52.6 billion in 2005.[4] Colombia received US$4.126 billion in remittances, 4.1 percent of its GDP. In Ecuador, remittances added to US$2 billion, 6.4 percent of GDP, and in Peru, the amount of remittances was US$2.5 billion or 3.2 percent of GDP.

Migrant remittance flows are significant in macroeconomic terms not only for their importance to GDP but also as a source of foreign exchange and, thus, for their impact on the current account. Additionally, remittances have a multiplier effect in the receiving economies because of potential growth opportunities in hometown associations and industries, such as tourism, transportation, trade, telecommunications, and even the money transfer industry itself.

Nevertheless, the potential impact of remittances on promoting access to financial services in Colombia, Ecuador, and Peru is not optimized because only a negligible percentage of remittances are received through a bank account. Moreover, remittance flows are not considered income on a credit application, leaving 35 percent of the income received by 20 percent of families in Colombia, 37 percent in Ecuador, and 24 percent in Peru out of the credit risk analysis.

Microfinance Service Supply Models

Recently, the growth of the microfinance sector in Colombia, Ecuador, and Peru has started to address the supply problem relative to the low levels of access to basic financial services in these countries. The emergence of microfinance in Colombia, Ecuador, and Peru is led by two types of institutions: banks specialized in microfinance and the leading banking institutions in each country.

Financial institutions in this market segment have been able to create sustainable and profitable business models that serve the segments of the population not served by traditional banks—with the introduction of products specifically designed for this purpose (Banco Caja Social Colmena in Colombia), the high efficiency of electronic payment methods (Mibanco in Peru), and best practices in credit risk analysis (Banco Solidario in Ecuador).

On the other hand, microfinance institutions still face great hurdles in their effort to massively provide basic financial services to the unbanked segment of the population in the three Andean countries. Because they are small, these institutions lack the investment capacity required to implement the infrastructures needed to apply best practices in terms of products, risk, alternative channels, and optimization of the impact of remittances.

The second type of institutions leading the microfinance markets in Colombia, Ecuador, and Peru are the leading banking institutions. Bancolombia (Colombia), Banco del

FINANCIAL institutions in this market segment have been able to create sustainable and profitable business models that serve the segments of the population not served by traditional banks.

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Pichincha-Credife (Ecuador), and Banco de Credito (Peru) are leading banking institutions that have followed this path; their new priority is to develop value offers aimed at low income segments through the implementation of new business models.

To optimize their existing infrastructures in the distribution of low-cost financial services, these institutions have decided to use downscaling strategies. This is the case of Banco del Pichincha-Credife (Ecuador), Bancolombia (Colombia), and Banco de Crédito (Peru). Banco del Pichincha-Credife and Bancolombia are the most relevant cases because of their use of best practices in the generation of alternative models of financial services distribution. Banco del Pichincha-Credife, through its existing network of bank branches, and Bancolombia, through the development of alternative distribution channels, have been able to create highly efficient business models that make it possible to bring financial services to a large portion of the population in these countries.

Nonetheless, other experiences that have yielded better results in countries where there are highly inclusive financial systems, such as Spain, Germany, Canada, or France, show that public policies that promote the necessary scale for institutions specialized in microfinance are needed to massively provide financial services to the population. The Colombian government moved in this direction with its Bank of Opportunities initiative, which aims to apply international best practices by creating a technical association of financial services that could provide these services to cooperative financial or banking institutions whose small size prevents them from individual access to these technologies.

Neither Ecuador nor Peru has come up with a policy similar to Colombia's initiative. Even though Ecuador and Peru have more appropriate regulations to foster microfinance, there is no public policy to promote economies of scale that could solve the supply problems that prevent access to financial services for large segments of the population.

Conclusion

The main cause for the low levels of access to financial services to low income segments of the population in Colombia, Ecuador, and Peru is the inadequate supply of financial services. This inadequate supply is explained by the high cost of financial services, the commercialization of services through costly and inadequately dense distribution networks, and the use of risk methodologies that are not adapted to the realities of developing countries. Furthermore, the regulatory frameworks observed in these three countries, as in most developing countries, do not favor the development of efficient distribution models of microfinance services.

This work has shown that the high price issue of financial services can be addressed with the development and distribution of low cost financial products. Also, the low density of bank branches can be obviated with a strategy of commercialization that takes advantage of low cost, alternative channels. The inadequacy of the risk methodologies can be resolved through the creation of new analysis systems that include the information from the vast informal economies of developing countries. ESR

Endnotes

1 Manuel Orozco, "International Flows of Remittances: Cost, Competition and Financial Access in Latin America and the Caribbean—Toward an Industry Scorecard" (prepared for Inter-American Dialogue, Washington, D.C., 12 May 2006).

2 Tova Maria Solo and Astrid Manroth, "Access to Financial Services in Colombia: The Unbanked in Bogota" (World Bank Policy Research Paper No. 3834, Social Science Research Network, Washington, D.C., 2006).

3 Federación Latinoamericana de Bancos, http://www.felaban.com.

4 The Multilateral Investment Fund, Inter-American Development Bank, http://www.iadb.org/mif. (Also available in Spanish.)

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