



E-Finance Global Initiative

Briefing Note

February 12, 2001

Global Financial Markets Group
International Finance Corporation

E-Finance Global Initiative

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Summary

The following briefing note is intended to provide information on IFC's e-finance global initiative, covering:

- I. ***The e-finance core component*** - its objective and basic model;
- II. ***The e-finance initiative*** - their implementation methodology and the cooperation with best practice partners and technology providers;
- III. ***The supporting initiatives*** - the April conference on micro and small business lending, the global credit bureau initiative, and the mobile banking and mobile payments systems practice area.

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Background

The financial services industry is undergoing dramatic changes caused by recent significant technological advances and the explosion of services offered on the Internet. The revolution underway can significantly accelerate financial sector development in many countries by reducing costs to consumers of financial services, increasing breadth and quality, and widening access to financial and non-financial services. Globalization, economic integration within and across countries, deregulation, technological advances in telecommunications especially in cable and wireless communication technologies, and the spread of the Internet are dramatically changing the structure and nature of financial services provision and financial services industries around the world. Internet and other technologies are not just alternative distribution channels, but are fundamentally changing the business model.

The Internet is about reach, richness and relationships. It allows people and businesses to communicate one to one or many to many, provides access to vast amounts of information gives access to global markets, and provides transaction support (B2B, B2C, and C2C). Financial institutions can have a much richer exchange with their customers and can create and tailor products and services that meet the evolving needs of their customers. At the same time, the Internet poses a threat: it allows new financial service providers to more effectively compete for customers because it does not distinguish between traditional "bricks and mortars" institutions and those without physical presence. Increasingly, consumers and businesses are comfortable with alternative payment mechanisms provided through the Internet. These forces are leading to large benefits for consumers of financial services at both the retail and commercial level.

The advances in technology are resulting in fundamental changes in the basic structure of the financial services industry on a global basis. Technological advances are leading to the entry of new types of financial services providers within countries and across borders, including online banks, brokerages, mono-liners and so called aggregators (which allow consumers and businesses to compare financial services, e.g., loans, saving rates, insurance policies etc). In addition, there is a proliferation of new types of non-financial entities that are offering a whole range of financial services, many of them directly competing with banks and the formal financial intermediaries. Many of these companies are dedicated to the provision of one kind of service, while others are adding financial services to their traditional line of business. The latter include utilities and telecommunications companies that offer various forms of

payment or other services via use of their existing distribution network and customer relationships. Vertically integrated financial service organizations that try to create synergies by combining brand names, distribution networks and financial service production are rapidly growing.

The IFC has recognized the critical importance of financial, information & communication technologies impacting developing countries, by offering unprecedented opportunities for market access and high-wage employment. Moving beyond traditional telecommunications infrastructure projects, IFC has expanded its activities to Internet software, service, and applications providers via investment in venture capital funds, incubators, and direct equity investments. An emerging priority, which has received scant attention to date, is the potential for IFC to “e-enable” its existing client companies – helping them to increase their effectiveness by leveraging on new technologies.

IFC’s large portfolio of investments in financial intermediaries represents the strongest set of candidates for this approach due to: (i) extensive SME relationships; (ii) intermediary role levers IFC impact; and (iii) the natural role of the financial system as a payment platform for e-commerce.

1. The e-finance core component

1. Objective:

The E-Finance Small Business Initiative’s aims to assist Financial Institutions (FIs) increase their efficiency in and volume of financial services targeted to small- and medium-sized enterprises (SMEs), by capitalizing on recent advancements in financial, information & communication technologies. The ultimate goal is to help financial institutions seize market opportunities in SME financing thus demonstrating that SME financing can be profitable and sustainable.

The central component of the Initiative is the creation of a model that enables FIs to focus on the risk profile and product needs of its SME clients. It entails the integration of technologies that allow FIs to simultaneously collect and analyze significant amounts of client information on an on-going/real-time basis. FIs could then make considerably better credit decisions and provide targeted financial products that meet the changing needs of a growing SME client base.

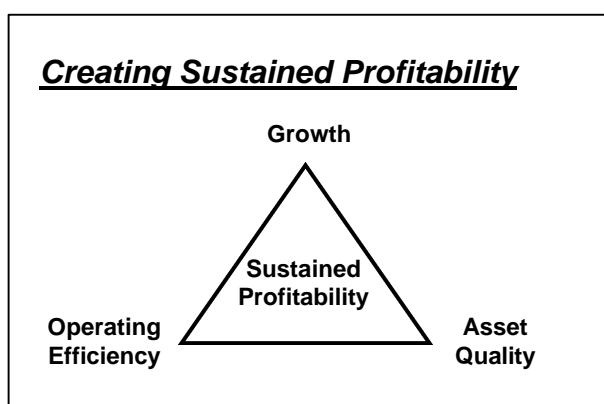
The model will be tailored to address organization-specific capacity building needs in applying technology innovations to: reduce transaction costs; improve credit risk management capabilities; increase volume of investment in SMEs; introduce a range of additional financial services such as payroll processing, receivables management, and supply chain distribution; provide linkages to business development services such as training, and access to world markets.

In a first phase, IFC will be developing six pilot projects with clients in different regions in the world, which will apply and put to practice the e-finance model, based upon best practice globally and in collaboration with outside partners where appropriate. The pilots will be carefully chosen to represent different institutional, economic & country conditions, thus to ensure broadest replicability and demonstration effects.

2. E-finance model:

IFC’s e-finance model takes a holistic approach to the operations of a financial institution, embracing both traditional and new distribution channels, products & service offerings. It centers around the three key factors that ensure sustained profitability in SME lending: **1. Operating Efficiency**; **2. Asset Quality**; and **3. Growth**. Operating efficiency has to address the constraints of small loan sizes, the non-

reliability of financial information, the limited access of clients to financial services, and the often non-existing track record of SME clients with financial institutions. To address these issues successfully, a paradigm shift is necessary from “relationship” lending to a “mass-customized” approach: Moving away from small business lending as corporate lending with its constraining and costly requirements of individual credit analysis and risk assessment towards a portfolio approach that allows to mass-customize financial products & services. “Mass-customized” lending in turn requires risk management systems that allow to keep control & improve transparency of asset quality. To achieve both improvements in operating efficiency and asset quality, financial institutions generally need to meet certain growth targets in order to generate sufficient volume necessary for a portfolio approach.

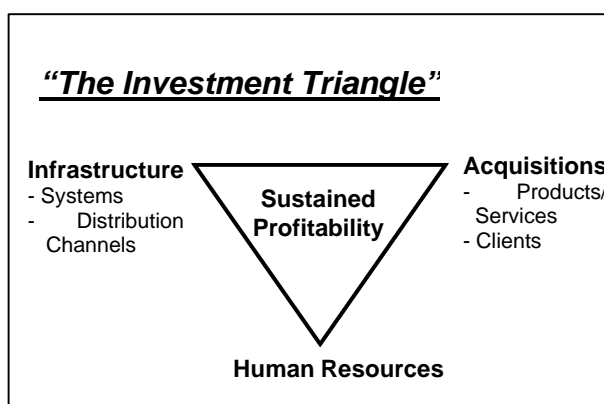


To reach high operating efficiency, growth & strong management of asset quality, investments in the following three areas are necessary: **1. Infrastructure**; **2. Acquisitions**; and **3. Human Resources** (represented as “the investment triangle”).

Infrastructure investments are divided into investments in (a) systems and (b) distribution channels.

Systems include:

- *Centralized Back-Office* to free staff time in sales and service areas & to consolidate processes consistently across the organization;
- *Management Information Systems (MIS)* to allow for profitability analysis by client, product, distribution channel & profit center;
- *Customer Relationship Management (CRM)* systems to facilitate consistent multi-channel management, client segmentation & targeted cross-selling and up-selling to maximize the profitability of the client relationship & increase service quality;
- *Decisioning Systems* like credit scoring and cash-flow scoring to reduce operating costs, improve asset quality, and increase client profitability.



Distribution channels include:

- *Light branches* that leverage captive relationships with large corporates or company clusters to provide services to employees and suppliers based on front-end staff only;
- *Agent networks* that increase outreach to small business clients;
- *ATM networks* that include broadened functionalities and/or are adapted to remote banking requirements;
- *Electronic channels* using the Internet to provide traditional e-banking services plus broadened offerings such as receivables management, e-procurement, small business information services;
- *Mobile banking channels* using mobile phones to provide e-banking services via SMS or WAP technology plus future payment functionalities.

Acquisitions focus on (a) products & services, as well as on (b) clients. Acquiring the knowledge to deliver products & services requested by the clients is necessary to maximize the client relationship by

providing comprehensive product offerings. In cases where acquisition is not an option, partnering becomes the alternative, which applies to traditional products & services such as leasing, insurance, and information services, as well as to more advanced offerings such as e-procurement via marketplaces, e-commerce support for small businesses, and payment solutions via mobile phones. Acquisition of clients is critical in those cases where sufficient volume to drive small business lending cannot be achieved through organic growth. Where acquisition is not an option partnering may be an alternative, e.g. in cases of SME supplier finance for large corporates.

Human resources is a core element for the success of the e-finance pilots and is one of the most important investment areas. Depending on the competitive situation of a given country, qualified staff is one of the key limiting factors to growth. As such, investing in training of staff is critical to provide financial and non-financial services to SMEs. Training of new staff goes hand-in-hand with redeployment and training of existing staff that may be freed from time-consuming administrative functions through centralized back-offices and rationalized decisioning systems.

II. The e-finance initiative

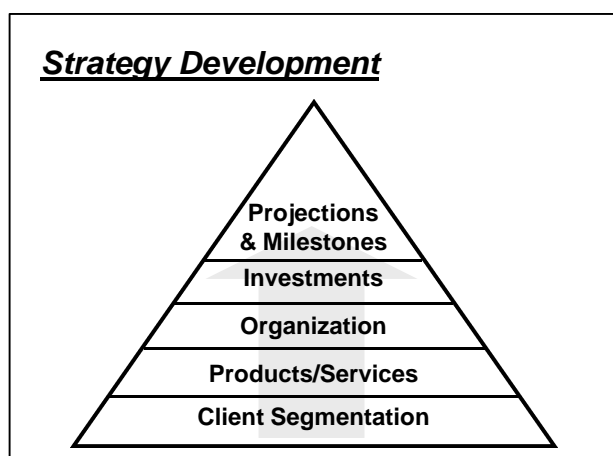
The e-finance initiative is piloted in six different regions of the world to put into practice the e-finance model, allowing for country and institution-specific adaptations as well as the deployment of new and innovative technologies, product & services solutions to emerging and transition countries.

1. Implementation methodology:

The implementation of the e-finance pilots with each institution is carried out in three stages:

1. The first stage is the **commitment phase** where senior management has to buy in and a champion for the e-finance initiative has to be appointed.
2. The second stage is the **strategy development phase** and represents the main part of the work: It is here that IFC's role finds its greatest leverage, and which is elaborated in more detail below.
3. The third stage is the **implementation phase** which builds upon the planning and milestone setting of the strategy development and links it to IFC's investment & monitoring.

The **strategy development** takes a bottom-up approach with the customers as the starting point. A target market analysis and detailed client segmentation provides the basis to go to the second step, which is the development of products & services targeting these client segments. This generally starts out with an IFC presentation/roundtable of opening possibilities, drawing on best-practice from different countries. At this stage, focus groups with clients become a powerful tool to develop jointly with the clients product and services specifications and needs that would later provide the basis for a prioritization of product offerings. The third step is to review organizational changes to be able to deliver the products & services to the target client markets. Among others, this would include the clear separation of back-office from front-office functions and may include the separation of small business finance from the corporate finance side. Next, the investment needs are



specified accordingly and within the framework laid out above, which then ties into the planning, setting of milestones, and the structuring of IFC's investment to support and facilitate the implementation.

In this process, IFC's role goes beyond our traditional role as an investor by leveraging our analytic skills and experience to become a pro-active partner in developing sustainable financial institutions serving the SME market. In addition to IFC as an investor, three distinct areas of contribution define IFC's new role:

1. IFC as a **Coach**: From the initial phase of building management commitment throughout the strategy development phase IFC provides guidance and eventually ensures the setting and meeting of milestones during implementation.
2. IFC as a **Knowledge Manager**: IFC is in the unique position to share knowledge of best practice and emerging technologies & SME financing solutions across continents, and to foster the development of specific adaptations to emerging and transition market environments, e.g. in the case of developing standardized microfinance banking software that allows for easy adaptation of credit scoring at a later stage.
3. IFC as a **Gate Keeper**: In assessing international best practice and identifying potential partners, IFC's leverage allows to bring leading technology providers to emerging markets & to ensure commitment to quality even for smaller financial institutions which may otherwise not rank high on their priority list.

<p><u>IFC's New Role</u></p> <p>Investor</p> <p>Coach</p> <ul style="list-style-type: none">- Coaching throughout strategy development and implementation- Ensuring milestone reviews & project assessment <p>Knowledge Manager</p> <ul style="list-style-type: none">- Sharing global expertise across diverse markets- Establishing and disseminating best practice <p>Gate Keeper</p> <ul style="list-style-type: none">- Pre-screening quality of service providers & partner companies- Facilitating international partnering & negotiating better deals

2. Technology & best-practice partners:

The IFC e-finance team is accumulating knowledge of and developing relationships with (a) **best practice partners** and (b) **leading technology providers** relevant to its e-finance practice.

Best practice partners are those institutions that have demonstrated excellence in their respective fields and whose examples and practice are deemed to have considerable impact for the development of small business finance in emerging and transition countries. Best practice partners will be selected upon their merits and may be associated with IFC's efforts through formal or informal working relationships. Most recently, the SME Department of IFC and the World Bank has signed a partnership agreement with ACCION, which is a leader in introducing credit scoring to microfinance institutions (Mibanco, Peru), applying Palmpilot-based remote banking devices for loan officers (Mexico), and introducing smartcard systems for microfinance institutions (Costa Rica & Mexico).

A reference list of **leading technology providers** and consultants is developed based upon their offerings and references. IFC has started discussions with a wide range of technology providers, among them leaders in credit scoring, systems integration, payment solutions, e-services providers, market research companies, as well as specialized technology developers and local consultancy companies. As an integral part of IFC's e-finance practice, it will develop this list into a reference tool for solution providers relevant to transition and emerging markets. IFC ensure reference checks of providers to be placed on this list and will both spend time and efforts in bridging communications of technology needs in client countries with the respective developers through regular & occasional exchanges & roundtables.

III. Supporting initiatives

As an integral part to IFC's holistic approach for its e-finance initiative, three supporting initiatives have been developed (1) to facilitate early dissemination of best practice from the pilots to a broader audience, and (2) to address shortfalls in critical infrastructure for SME lending:

- 1. International Conference on Micro and Small Business Lending:** In cooperation with the WBI, IFC will be hosting an international conference on credit scoring and credit information for small business lending in Washington DC on April 2 and 3, 2001. This conference will bring together best-practice in small business finance worldwide and is meant to provide a unique occasion to meet with state-of-the-art technology providers and leading small business lenders. Among the participants are the following institutions:
 - *Wells Fargo*: the largest small business lender in the US.
 - *Fair Isaac*: internationally renown as the leader in small business credit scoring.
 - *Trans Union*: one of the largest international credit bureaus with scoring expertise.
 - *ACCION/Lisim*: pioneers in introducing credit scoring to microfinance institutions.
 - *CRIF*: the leading Italian credit bureau and innovative scoring developer with growing international exposure.
 - *SME Loan Hong Kong*: developer of cutting-edge web-based scoring model for cash flow based lending.
 - *Heller Financial*: global leader in vendor finance & application of sophisticated decisioning models.
 - *Moody's*: experts in assessing the strength of scoring & risk management applications and their use for funding strategies.

- 2. Global Credit Bureau Initiative:** As credit information – in particular consumer credit reports – are critical in small business lending, IFC and the World Bank are joining forces to push the agenda for the development of functioning credit bureaus. While the World Bank would provide advice on the regulatory framework and best practice for regulations including privacy & data protection laws, IFC is currently advancing discussions with leading international credit bureaus to define investment opportunities in priority countries.

- 3. Technology Practice Area - Mobile Banking and Mobile Payment Systems:** Today, mobile phone penetration exceeds bank account or credit card penetration in many of our client countries. Thus leveraging the use of mobile communication devices is one of the key technologies to make financial services available to a large part of the population. The three important areas of application of mobile technologies are:
 1. *Mobile banking for SME clients* – either SMS or WAP based solutions to offer traditional e-banking offerings, such as money transfer, account information, cash management – all critical for the management of small businesses;
 2. *Remote banking capabilities for loan officers* to allow loan officers reach clients and provide comprehensive and quick service to microfinance customers;
 3. *Mobile payment systems* to facilitate non-cash payment options for small businesses, reduce cash handling risks & expand formal financial sector penetration.

Leading financial institutions, mobile phone operators & equipment manufacturers in industrialized countries have recently began to adapt various technology solutions for each of the three areas. However, their focus has so far remained limited to applications in developed markets, not yet realizing the tremendous opportunities in emerging and transition countries where mobile phones are

rapidly gaining ground. IFC can bridge this gap between technology developments in developed markets and possible applications in its client countries, both through IFC's local & global knowledge as well as through its industry experience in telecom and financial sector investments. As such, IFC is in the unique position to facilitate and initiate technology transfer that would eventually allow financial institutions in emerging markets to leverage these innovations and leap-frog intermediate stages of development.