

Financial Technology in Latin America

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Abstract:

Latin America has a large unbanked or underbanked population that owns smartphones. This population is in a position to benefit from the rapid growth in Fintech companies such as neobanks in the region. New regulatory frameworks have also evolved in the region, which have stimulated the growth of the Fintech industry. An additional benefit of Fintech at the national level is that the digitization of financial services helps to formalize the informal economy. The benefits offered by Fintech companies were especially apparent during the COVID-19 pandemic. A large number of disadvantaged groups had accounts with Fintech companies, which provided them access to essential services such as the delivery of medicines and groceries at home during the COVID-19 pandemic that would not otherwise be possible.

Keywords: finance | pandemics | sociology | companies | statistics | smart phones

Article:

Financial services are inaccessible and unaffordable for a majority of the population in Latin America. One estimate suggested that about 70% of the population in Latin American economies is unbanked or underbanked (<https://tinyurl.com/y525aj9m>).

In order to open an account in most Latin American countries, banks demand a variety of documents in addition to identification cards. They include a proof of a job, documents to prove residency or citizenship, and other relevant documents. For instance, to open a checking account, banks in Chile require four or more documents¹ including two years of residency in the country (<https://tinyurl.com/y5133ugq>). Financial institutions have imposed these oppressively burdensome requirements in order to prevent money laundering and other illegal activities (<https://tinyurl.com/lgn5qbk>). Some banks do not serve individuals if they are not among the top 20% of the national income distribution. (<https://tinyurl.com/y5133ugq>).

Low-income people in the region also suffer from high costs of financial services. Most bank cards and credit cards that target the poor have many hidden fees. (<https://tinyurl.com/y5133ugq>). For instance, consumers in Brazil are reported to pay an annual average interest rate of 190% for

an unsecured overdraft, credit card, and consumer loans (<https://tinyurl.com/lt7s5pc>), which can go up to 450% for some loans (<https://www.finnovista.com/en/radar/brasil-recupera-el-liderazgo-fintech-en-america-latina-y-supera-la-barrera-de-las-370-startups/>).

An encouraging sign is that financial technology (Fintech) startups are introducing innovative solutions to expand financial services to these disadvantaged groups. In this article, we highlight the roles of Fintech to improve the access to and affordability of financial services to unbanked or underbanked populations in Latin America. Note that Fintechs are computer programs and other technologies, which support the delivery and use of banking and financial services. Some examples include mobile money or contactless payments, nontraditional credit scoring models based on information from consumers' social media behaviors, cryptocurrencies, and artificial intelligence (AI)-enabled chatbots used by financial institutions to help customers² Neobanks, also referred to as online banks, Internet-only bank, or digital banks, which operate without physical branches, constitute an interesting category of Fintech companies in the region.

LATIN AMERICA'S ATTRACTIVENESS AS A FINTECH MARKET

There are strong business opportunities for providing financial services to fulfill the banking and financial needs of the unbanked population in Latin America. According to Euromonitor International, the number of cellphone subscribers in the region reached 105% of the population in 2018. About two-thirds of all mobile connections in Latin America were smartphones in 2018 and the proportion is expected to increase to 79% by 2025 (<https://tinyurl.com/y3v38rp7>). Given that banking needs of only about 30% of the population in the region are currently being met (<https://tinyurl.com/y525aj9m>), there is a large unbanked or underbanked population that possesses smartphones. Fintech companies in the region are thus rapidly growing to meet unmet financial needs of this group (see Figure 1).

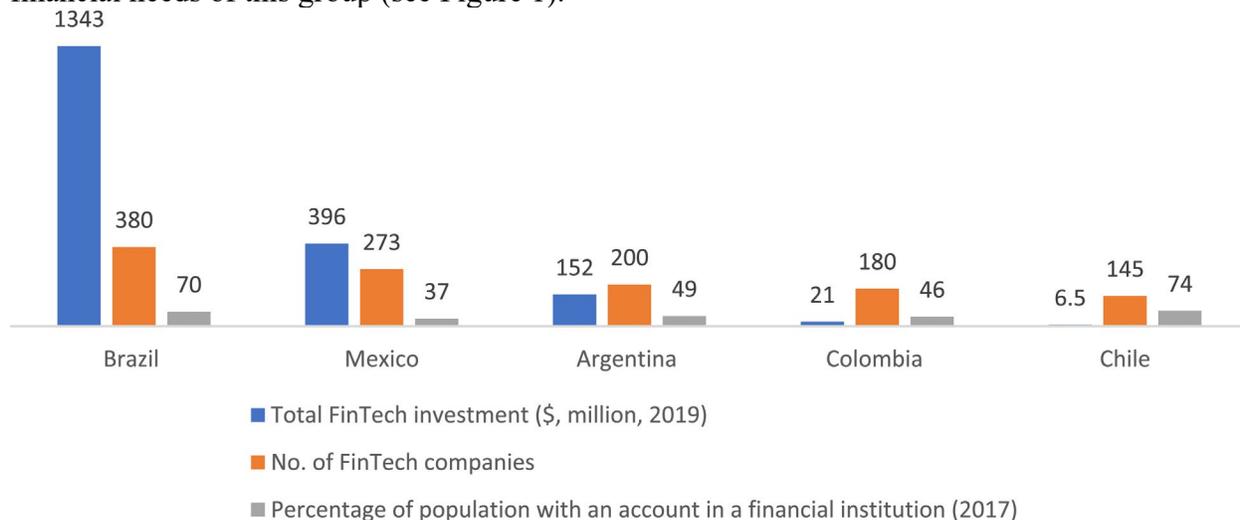


Figure 1. Access to financial services and the Fintech industry in major Latin American economies.

Unsurprisingly the region's Fintech sector is gaining traction as a magnet for venture capital and other types of investment.³ According to Fintech Open Innovation Platform Finnovating, Fintech

and insurance technology (Insurtech) companies in Latin America raised US\$2.66 billion in 2019 (<https://tinyurl.com/y2mbehy5>). Figure 1 presents the top five countries in terms of total investment and number of Fintech companies.

Data source: Investments (<https://tinyurl.com/y2mbehy5>); Number of companies in the Fintech sector: Brazil and Mexico (November 2019) <https://tinyurl.co/y3ngbywz> (2019), Argentina, June 2020 (<https://tinyurl.com/y3lteroz>), Colombia March 2019 (<https://tinyurl.com/y58wtwak>), Chile March, 2020 (<https://tinyurl.com/yyvbqztk>); Percentage of population with an account in a financial institution (The World Bank).

The rapid growth in Fintech companies in Latin America can be partly attributed to Fintech friendly regulations in the region's major economies. Mexico enacted its Fintech law in March 2018, which provided a process for new fintech models. Before the law was introduced, fintech ventures in the country were operating under a regulatory grey area (<https://www.seedstars.com/magazine/fintech-regulations-mexican-case/>). The new legislation stimulated a rapid increase in the number of Fintech startups. About 100 new Fintech companies were created in the country in 2018 alone (<https://tinyurl.com/yychrxa5>). A goal of the new law is also to reduce the use of cash in order to fight money laundering and corruption. Moreover, the law is expected to formalize the country's huge informal economy (<https://mexiconewsdaily.com/news/85-apply-to-operate-under-new-fintech-law/>).

Under the Fintech Law, Fintech companies are broadly subject to similar regulatory and supervisory requirements that are applied to banks and other financial institutions. A special part of the law involves the creation of a sandbox regime for Fintech startups. The regulatory sandbox allows Fintech startups to operate under a temporary license for up to two years without complying with all the regulatory requirements at once. This allowed new Fintech companies to test innovative solutions serving only a small number of customers. (<https://tinyurl.com/y3qv5yv7>).

Mexico's new Fintech regulation also generated a spillover effect in the region (<https://tinyurl.com/yychrxa5>). For instance, in 2018, the Brazilian government allowed Fintech companies to offer limited loans using electronic platforms (<https://tinyurl.com/y68d2u76>). The new regulations allow Fintechs with a minimum capital of 1 million reais (about US\$177,740) to offer peer-to-peer (P2P) lending. As of 2019, annual loan disbursement by Fintech companies in the country was about 2 billion reais (about US\$355 million) which is expected to increase thanks to the new regulation (<https://www.latinfinance.com/magazine/2019/spring-2019/brazils-central-bank-policies-encourage-fintech-startups>).

Likewise, the Chilean government is expected to submit a Fintech bill to congress in 2020. With the new law, the Chilean government expects to effectively oversee and monitor the Fintech market and standardize the services offered by Fintech companies. With Fintech innovations, the country also wants to transform itself as a regional financial center (<http://www.hgomezgroup.com/en/2020/06/30/fintech-in-chile/>).

BARRIERS OVERCOME BY FINTECHS AND BENEFITS OFFERED TO THE UNBANKED OR UNDERBANKED

In Table 1, we provide some representative examples of Fintech companies in some Latin American economies. These companies have helped overcome various barriers to financial service access in these economies.

TABLE 1. Some examples of Fintech companies in Latin America.

Fintech company (country)	Brief description	Number of users/accounts
Movii (Colombia)	<ul style="list-style-type: none"> • Uses AI and machine learning to analyze Movii consumption profiles and previous behaviors offer (Colombia) small-dollar "nano-credits" (https://contxto.com/en/startups/startup-movii-solution-ensuring-growth/) • Provides mobile wallets that are linked to prepaid Mastercards (https://tinyurl.com/v2b2qhex). 	<ul style="list-style-type: none"> • September 2020; 1 million customers
Nubank (Brazil)	<ul style="list-style-type: none"> • International credit cards, personal loans and savings accounts with zero fees • Services are provided online and thus no need for physical documents or branch visits • More competitive rates than traditional banks (https://www.ft.com/content/c0014ce4-6273-11ea-abcc-910c5b38d9ed) 	<ul style="list-style-type: none"> • July 2020: 25 million (https://nearshoreamericas.com/brazils-nubank-acquires-us-software-firm-cognitect/) • September 2020: 30 million (https://tinyurl.com/y3ef247r)
Ualá (Argentina)	<ul style="list-style-type: none"> • Offers prepaid debit cards, transfers, payments and savings and lending services (https://tinyurl.com/y2cvxqgh) 	<ul style="list-style-type: none"> • November 2019: 1.3 million issued cards (https://tinyurl.com/y47ggpbp).
Kueski (México)	<ul style="list-style-type: none"> • Analyses credit history, information collected using a credit questionnaire, online activity, socio-demographic information and other relevant data to assess borrowers' creditworthiness • Uses AI to tackle fraudulent activities in loan application process 	<ul style="list-style-type: none"> • July 2019: more than 1.5 million loans worth US\$220 million provided (https://tinyurl.com/y28u3gi)

First, in many countries in the region, unfavorable geographic conditions lead to the lack of access to traditional financial services. For instance, 40% of Brazil's population lives in rural areas where it would make no economic sense for banks to open branches. However, according to Euromonitor International, Brazil's smartphone penetration was 74.1% in 2019. This provides an opportunity for mobile Fintech payment services (https://www.ey.com/en_gl/financial-services-emeia/lessons-to-be-learned-from-Fintech-adoption-in-brazil).

A similar situation exists in Mexico. About seven million Mexicans, or 6% of the country's population, live 4.3 miles or farther from the nearest point of traditional financial infrastructure, such as physical bank branches, cash machines, agents, or point-of-sale terminals. For the town of Nueva Palestina in the southern state of Chiapas, where 10 000 people live, the nearest bank branch is more than 50 miles away (<https://www.euromoney.com/article/b1klktqwt9s9fy/financial-inclusion-mexico-plans-a-bank-building-spre>). Likewise, in Colombia, the availability of banking services is highly concentrated in urban areas (<https://www.oecd.org/dev/pgd/45965165.pdf>) and less than half the country's population had an account in a financial institution in 2017 (see Figure 1).

Geographic barriers are not the limiting factor to access financial services provided by Fintech companies (see Table 1). The Guadalajara, Mexico-based Kueski provides loan services to

Mexicans without any collateral or a personal meeting with the borrower. Kueski uses alternative information such as the number of social-media friends to provide faster and easier credit. Individuals can apply for a loan with Kueski via a computer or a smartphone.⁴

Second, traditional banks in the regions are highly bureaucratic and inefficient. Customers often need to wait in long lines to get the services offered by these banks (<https://tinyurl.com/y5l33ugg>). Neobanks offer all their services online. Brazil's Nubank, which is the largest online bank outside of Asia (<https://www.vox.com/recode/2019/6/5/18654454/nubank-softbank-valuation-brazil-banking-funding>), has simplified the credit process. Its customers use an app-based system, which takes 20 minutes to register an account (<https://tinyurl.com/y53brxus>). As of 2019, it was the sixth-largest credit card issuer in Brazil (<https://www.fastcompany.com/company/nubank>). Nubank approves a credit card within 1 day and delivers the card within 8 days. These processes take 1 to 21 days and 8 to 31 days respectively for the country's major banks (<https://tinyurl.com/y53brxus>).

Likewise, consumers install the Movii app from Google Play. After registering, they can load money into their Movii wallets by paying cash to a Movii agent. A large network of Movii agents (known as Moviired) exists in the country. Consumers can use the funds in a number of activities such as purchasing digital contents, paying utility bills, recharging mobile voice and data services, and transferring money to other Movii accounts (<https://tinyurl.com/yya869dp>).

A third problem is related to the high costs of financial services. Traditional banks allegedly charge predatory fees on services they provide such as debit and credit cards (<https://tinyurl.com/y5l33ugg>). Compared to traditional banks, Fintech companies provide these services at more competitive rates. For instance, there are no hidden fees in the services provided by Nubank (<https://tinyurl.com/y53brxus>).

ROLES DURING THE COVID-19 PANDEMIC

Latin American Fintech companies provided financial services to disadvantaged groups during the COVID-19 pandemic. For instance, the Colombian Government implemented the economic support program “Ingreso solidario”⁵ to help vulnerable households. The Fintech company MOVii was selected as one of the companies to deliver the services. With the MOVii apps, consumers were able to send and receive money at no cost and pay utility bills. MOVii card also allowed them to withdraw money from ATMs and pay at major stores.

Brazil's Nubank created a US\$3.8 million fund to support its customers during the COVID-19 pandemic.⁶ It teamed up with Brazil's food delivery company iFood, on-demand delivery mobile app Rappi, Hospital Sírio-Libanês, and healthcare platform Zenklub to provide diverse services such as the delivery of food and pharmaceutical products and medical assistance. For instance, Nubank offered to provide credits to customers who were unable to leave homes to buy groceries and other essential items. Affected customers received free food delivery by iFood and Rappi. Likewise, Nubank collaborated with Hospital Sírio-Libanês, customers to provide online appointments via video at zero cost. The hospital made 1000 consultations available to Nubank's customers.

CONCLUSION

Latin America has a large unbanked or underbanked population that owns smartphones. This population is in a position to benefit from the rapid growth in Fintech companies such as neobanks in the region. New regulatory frameworks have also evolved in the region, which have stimulated the growth of the Fintech industry. An additional benefit of Fintech at the national level is that the digitization of financial services helps to formalize the informal economy.

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