



The Opportunities of Digital: How Financial Cooperatives Are Pursuing Digital Transformation in a Disrupted World



This study was prepared by BFA Global through the FinnSalud project in Mexico, with the generous support of MetLife Foundation. All opinions, conclusions and errors of omission contained in this document are solely those of BFA Global and are not attributable to MetLife Foundation or the cooperatives participating in the study.

ABOUT BFA GLOBAL

BFA Global is a research, advisory, data analytics and product innovation firm focused on the intersection of finance, data and technology. The team works with the world's leading tech innovators, development organizations, policymakers, financial service providers, and more to help build solutions that can contribute to more sustainable and inclusive economies. Founded in 2006 by David Porteous, BFA Global is headquartered in Boston and Nairobi with additional offices in Medellín and New Delhi and a presence in Johannesburg, Lagos, Accra, Madrid, Mexico City and Paris. BFA's flagship projects include Catalyst Fund and FinnSalud. Learn more at bflaglobal.com.

ABOUT FINNSALUD

innSalud is a 3.5-year program (2019-2022) funded by the MetLife Foundation, fiscally sponsored by Rockefeller Philanthropy Advisors, and executed by BFA Global in Mexico. The program is developing a set of financial health standards and a health measurement tool to shed light on the state of the financial health of the

Mexican population and inform initiatives that contribute to its improvement. We work with financial service providers to help them deliver products and services that support the financial health of their customers in a sustainable way.

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ACKNOWLEDGMENTS

We are grateful to each and every one of the staff members of the 31 cooperatives who agreed to participate in the study and generously shared their knowledge, data and perspectives on the state of digitization of their respective institutions. The complete list of participating cooperatives can be found in the Annex.

Special thanks to Leticia Jáuregui for her leadership of the initiative, to Jacob Winiecki for his insights and expertise on digitization, to Francisco Mier for the many hours devoted to conducting the interviews, to

Gabriela Zapata for enabling access to the cooperative community, and to Giovana Hernández for her support with the interview templates and analysis. We are also very grateful to Rachel Abbott for her invaluable ability to edit and shape this report.

We hope that the content presented here is useful to all cooperatives interested in digital transformation, as well as to the various institutions and individuals that support them in this effort.



LIST OF ACRONYMS

AI: Artificial intelligence

AML: Anti-Money Laundering

CRM: Customer Relationship Management system

e-KYC: Electronic Know Your Customer; digitized version of procedures to identify and verify a customer's identity

ERP: Enterprise Resource Planning; business management software used by an organization to collect, store, manage and interpret data from business activities, often through integrated applications

MVP: Minimum Viable Product; version of a product with just enough features to be usable by early customers, who can then provide feedback used by the company to further develop the product

P2P: Peer-to-Peer; payment platforms that allow individuals to transfer money to one another

ROI: Return on Investment

IT: Information Technology

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INTRODUCTION

Changing business and market requirements were already pushing financial service providers to pursue **digital transformation or digitization**, the process of using digital technologies to create or modify products, business processes, and customer experiences. The COVID-19 pandemic has accelerated this process. Interventions to contain the virus's spread have focused on restricting mobility and non-essential employment, and limiting in-person interactions. For financial cooperatives, these changes have meant that the need to digitize has intensified.

[BFA Global](#)'s 15 years of experience in the financial sector have given us insight into the forces shaping digital transformation and the challenges and opportunities it presents for financial cooperatives. In 2020, with the generous support from

MetLife Foundation, our [FinnSalud](#) program complemented this understanding with research in Mexico. We interviewed 31 of the 40 largest cooperatives, representing over 6 million members, to understand their digital transformation journeys, their motivations, and the barriers they face.

This paper shares insights on why cooperatives must pursue digital transformation and how they can do so effectively. We distill lessons from BFA Global's work in Mexico and present recommendations to help financial cooperatives around the world plan strategically, navigate a changing landscape, and better serve their members during a time of crisis.

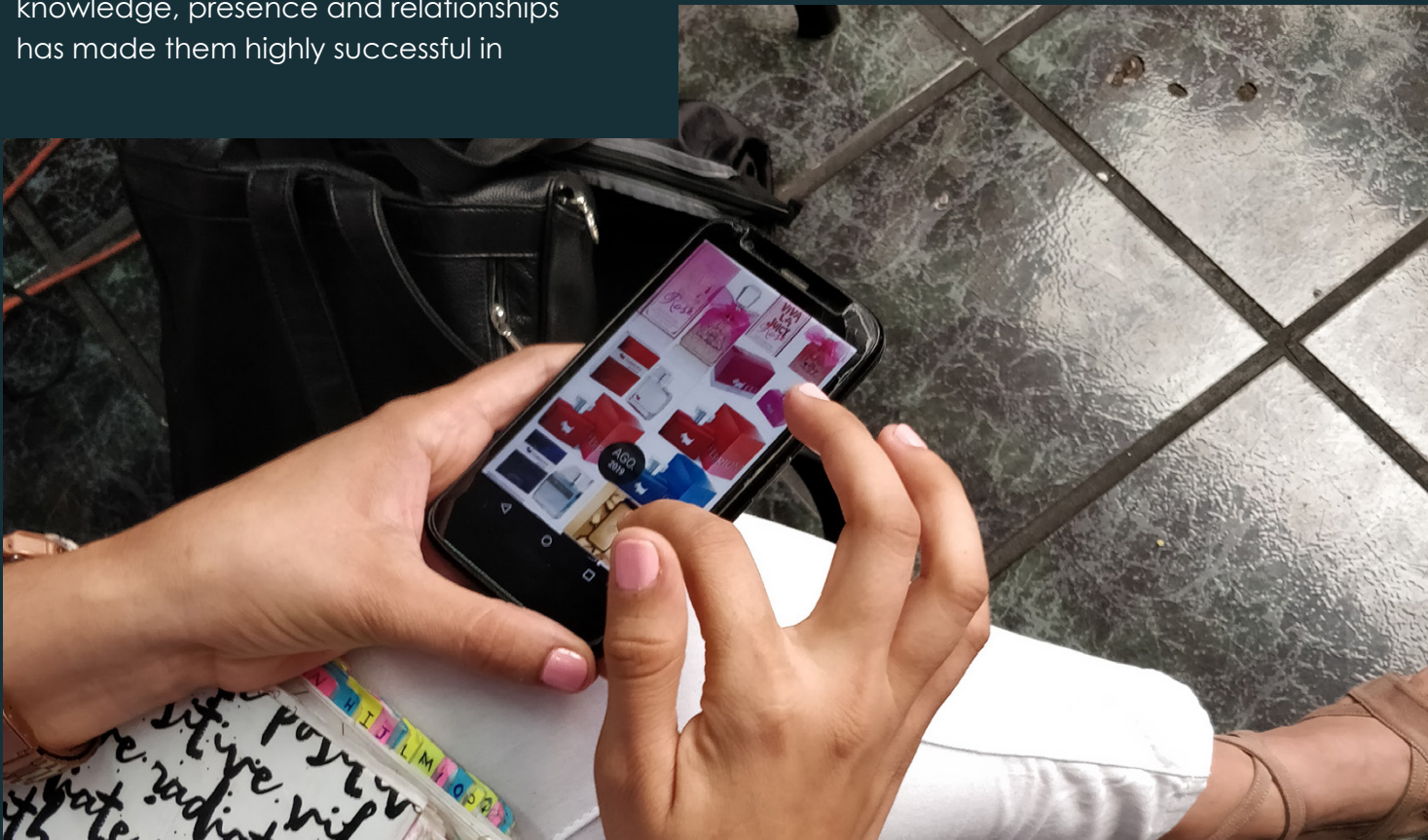


BACKGROUND

Digital technology has severely disrupted the financial sector. Before COVID-19 heightened the need to embrace technology, multiple forces were already intensifying the need to future-proof the traditional cooperative model. The rise of smartphones and the expansion of data connectivity has opened up a new world of potential channels for products, interactions, and customer service. In many markets, customer preferences have evolved along with this rise, with new expectations for product and service capabilities to be available anytime, anywhere.

Traditionally, cooperatives target populations that are underserved by the formal sector. Their ability to leverage local knowledge, presence and relationships has made them highly successful in

reaching these populations and delivering financial services that are appropriate and affordable. However, the core components of this traditional model—brick and mortar channels, cash distribution and collection, analog record-keeping, and in-person client or group meetings—are being challenged by the digital revolution. Cooperatives are increasingly facing competition from digitally-enabled banks, emerging fintechs, and the continued expansion of superplatforms into financial services. Add the COVID-19 pandemic to the mix and it's clear that to survive, cooperatives will need to improve their relevance in an increasingly digital world.



While there is no one-size-fits-all definition, **digital transformation in the cooperative sector** is the process of using digital technologies to either create new or enhance existing digitized processes, digital channels, digital products, and digital engagement:

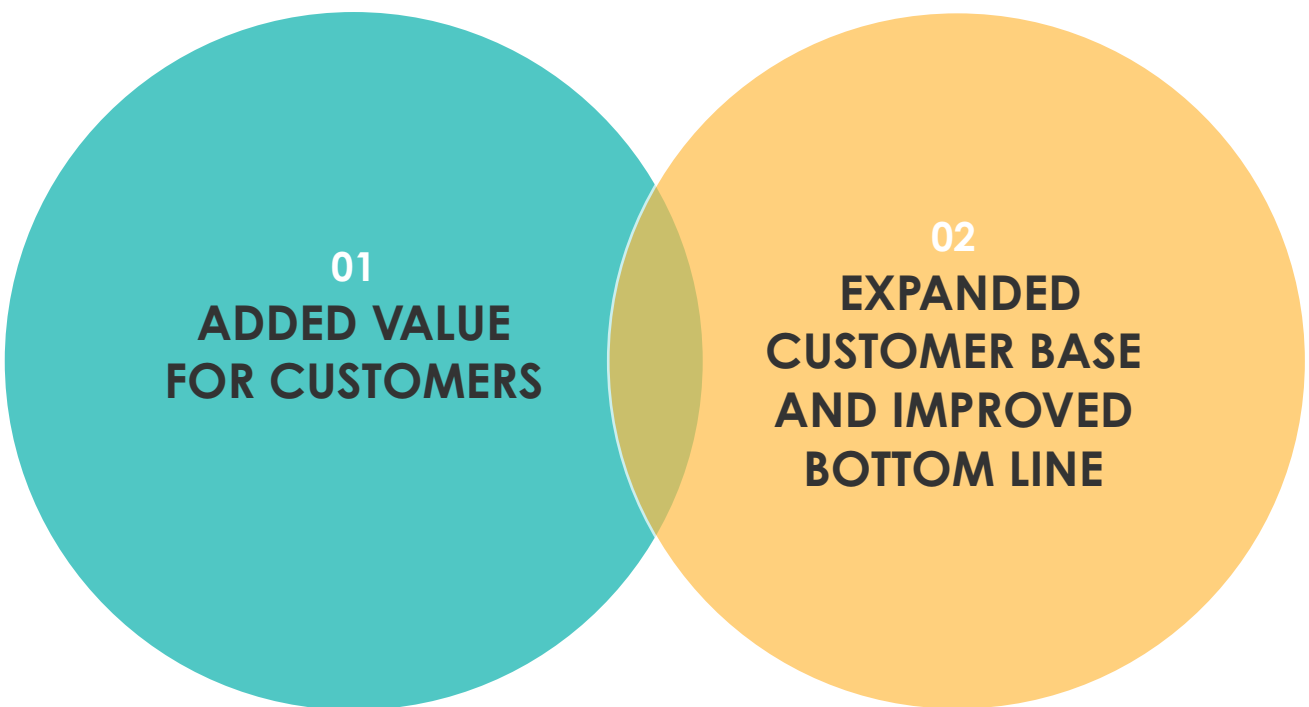


WHY DIGITIZE?

Digitized financial institutions and fintechs are beginning to reach into cooperatives' segments of the market. In Mexico, retail banks like Banco Azteca and BanCoppel are digitizing faster, and fintechs with fully digital offerings such as Destácame and MercadoPago are beginning to compete with cooperatives head-on. Cooperatives have to digitize to increase their competitiveness. They may be able to continue offering competitive borrowing rates, but this may not be enough to retain clients who are drawn to the convenience and customization that digitized providers offer.

In many cases, cooperatives' current membership is not yet demanding digital products and channels. There is a trust and human element built into the DNA of cooperatives where relationships between members, loan officers, and staff are important. A history of in-person interaction is central to these bonds. However, cooperatives urgently need to begin the digital journey now, even if it's not highly demanded at the moment. Cooperatives need to reach a younger generation of members who were born into a digital world and may not be attracted to the trust and relationships of the legacy cooperative model.

While there are many reasons to pursue digital transformation, the two most compelling benefits fall into two main categories:



— 3.1

ADDED VALUE FOR CUSTOMERS



By definition, a cooperative is a financial institution that is owned and governed by its members, making value for members critically important. Cooperatives can strengthen their value proposition to their members by digitizing. Specific enhancements may vary by organization and market, but for most financial institutions, the main improvements provided by digitization are:

Convenient access:

Through digital channels, cooperatives can offer members access to products and services at the most convenient times and locations. This can eliminate or drastically reduce the need for travel to branches to conduct transactions or access information, saving the member time and travel-related expenses.

Faster turnaround times:

Equipping field staff with digital devices and setting up digital processes within field operations reduces the time it takes to respond. Whether it's a quick loan application decision or replying to a transaction query, members don't wait as long to hear back.

Reduced decision-making burden:

The mental energy required to navigate financial issues and stay on top of obligations can be difficult. Digital transformation makes it possible to automate transactions that would otherwise require significant mental energy. For example, under BFA's OPTIX program, our partner Cooperativa Acreimex made it painless for payroll loan product members to save by automating savings deductions. The automation helped members develop discipline with their savings and reduced the mental hurdles that typically prevent saving behavior. This would be difficult with analog products and channels.

Customized engagement and better-targeted communication:

Digital communication and channels enable customization of the customer experience that's too expensive to deliver via an analog model.

Safer finances:

Travelling to branches can be expensive, time-consuming, and even risky, particularly when carrying large bundles of cash. Digital products offer members the ability to both transact and move with a store of value that's safe and secure.





Simpler data management:

Digital data can be collected, stored, retrieved, and used much more easily than paper data.



Channels for faster loan deployment:

Many cooperatives in Mexico have traditionally had high liquidity levels. Our research showed that, during the pandemic, many had higher than usual liquidity levels and were struggling to find people to provide loans to safely. Even though they have the cash, their credit scoring processes are often cumbersome and necessitate in-person interaction. With more sophisticated credit algorithms that are propelled by digital, cooperatives could pick the right people more quickly, and could potentially (regulation permitting) disburse electronically, overcoming multiple barriers presented by the pandemic.



Expanded financial inclusion and financial health:

Digital acquisition and distribution opens up opportunities with new customers. It could help cooperatives make inroads with younger customer segments they have not been reaching with the traditional model.



Data-driven decision making:

Digitized financial institutions sit on a mountain of data that can be mined for deep insights into customer behavior and portfolio characteristics, both forensically and in real-time. This enables accurate customer segmentation, pattern recognition, predictive algorithms, and data visualization, all of which inform decision-making.



Reduction of fraud and loss from cash handling:

Digital disbursement and collections can reduce what is typically a risky and human resource-intensive process. With a trackable money trail, cooperatives can prevent the loss of resources.



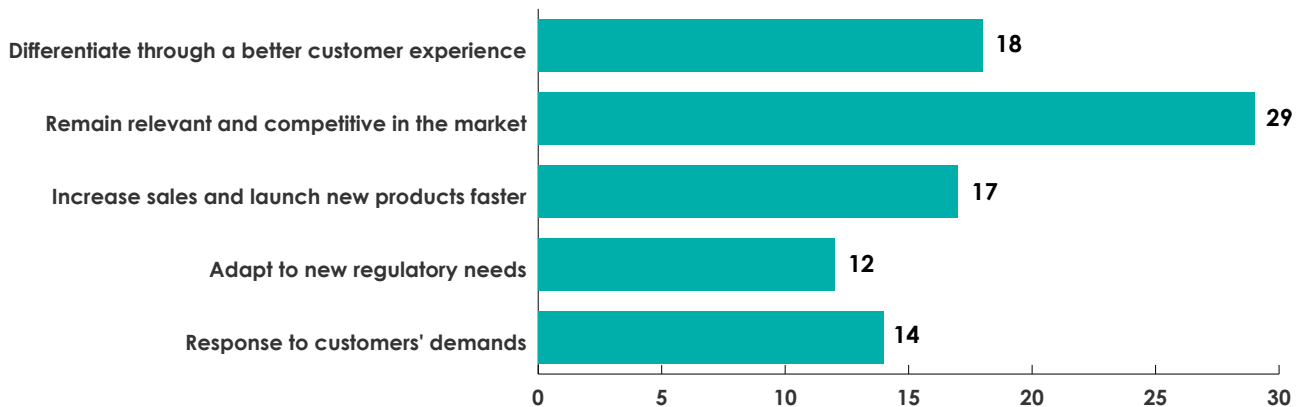
Enhanced brand reputation and customer retention:

Faster, more convenient, and more customized services can deepen client relationships and improve retention, particularly of those members who are already using digital services elsewhere.

FINDINGS FROM MEXICO

BFA surveyed 31 cooperatives in Mexico which collectively represent 6 million members. The majority of these cooperatives understand the need to digitally transform to improve operations and be more competitive with other financial service providers. Over 90% of cooperatives said a key motivator to digitize was the desire to stay relevant and competitive in the marketplace.

What are the reasons to digitize?



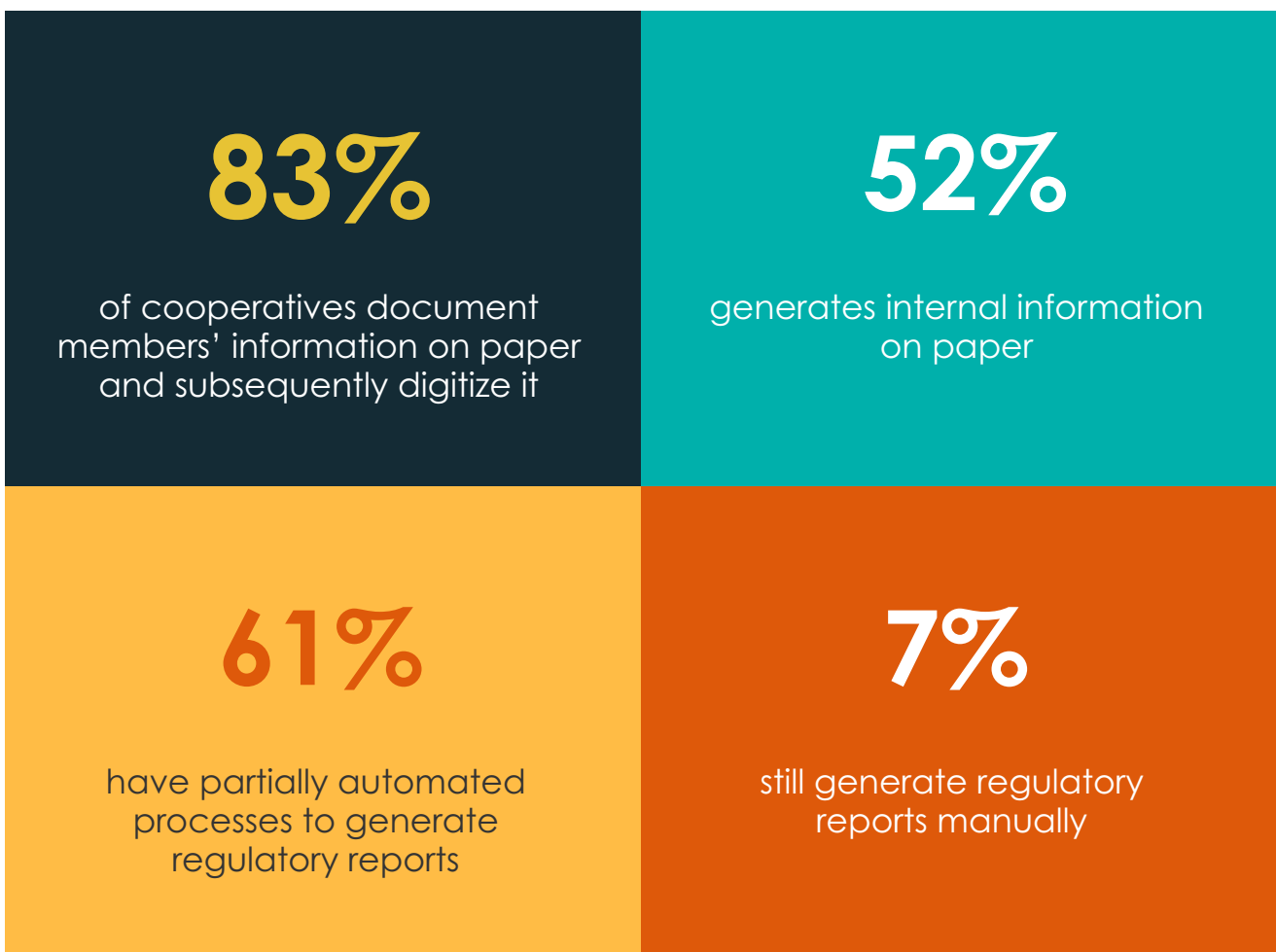
However, there is a general lag in technology in the cooperative sector. Automation, online presence, and digital offerings are all lacking, especially relative to banks and fintechs. Few cooperatives have carried out significant digitization initiatives. Nearly 40% of the cooperatives said they do not have a digital strategy approved by their board of directors. Some mentioned having isolated projects, but not as part of an overall digital strategy of the institution. Only 16% have a multi-year budget for digitization projects.

Most of the cooperatives we studied do not have a clear understanding of what digitization implies. On the whole, they do not know where to start, how to do it, how much it will cost, or what they need. This includes a lack of clarity around the talent needed to carry out digitization projects: 50% say they have a dedicated digitization team but are actually referring to their information technology (IT) systems or social media staff, not the existence of a designated team that would be required to carry out full digitization. Cooperatives urgently need support on digitization.

These findings were consistent across cooperatives of different sizes and locations, signaling that the other 124 authorized cooperatives in Mexico are most likely in a similar situation.

Digital Systems and Processes

Of the 40 cooperatives initially selected to participate in the study, all but one have an informative web page that includes general information about the cooperative, descriptions of some of their products, location of branches, etc. Most of these sites are very simple: they may allow members to view their account information, but don't enable them to carry out financial transactions. Fifty five percent of cooperatives require their members to go to a branch in person just to check their account balance. The level of automation for internal processes is low.



The majority of cooperatives use social media to announce their products and services and some communicate with members by chat. However, they don't have established strategies for capturing potential members through specific user profiles. This would be an easy and cost-effective way to acquire new members.

Expense Tracking

Many cooperatives are paying for a variety of outdated systems, sometimes without even realizing it. None of the interviewed cooperatives had complete and up-to-date information on their spending on IT systems and platforms. Their maintenance expenses are lightly monitored. The technology investments they make appear to be poorly systematized. Based on responses from cooperatives with higher-than-average expense tracking, it appears that cooperatives invest a significant proportion of their budget on digital systems. Despite this, they do not measure the ROI of their investments.

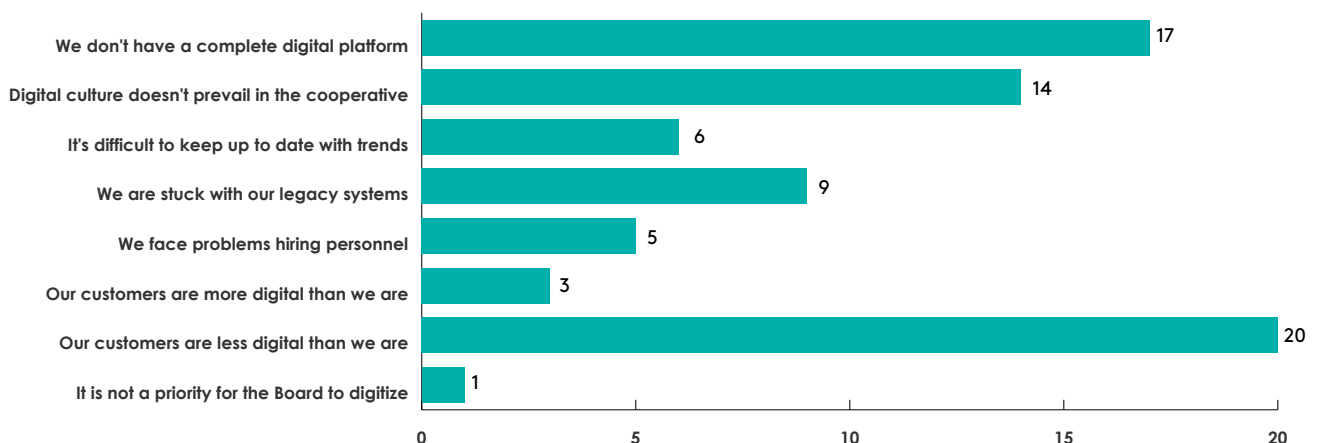


The Path to Digitization

The cooperatives generally do not understand their members' digital capabilities, needs, and preferences. For example, 71% of cooperatives offer debit cards, and 77% offer ATMs, but the majority of cooperatives report that a large number of their cards are inactive. In other words, their members either don't want or don't need debit cards. ATMs and debit cards require considerable financial investment and staff. Even though this is most likely unprofitable, the cooperatives continue investing. Failing to base digitization decisions on the customers will lead to low adoption and lost revenue.

Only 45% of the cooperatives we interviewed said that meeting demand from their members was a key motive for digitizing. Twenty of 31 cooperatives said a key challenge related to digitization was that their customers were less digital than they were. There is a risk that cooperatives without overt demand from their members will deprioritize digitization, causing them to fall too far behind other financial service providers.

What challenges are you facing regarding digitization?



Opportunities

Cooperatives are not capitalizing on economies of scale. For one, if cooperatives used the same core banking system, they would all benefit from improvements to the system. Instead, the 31 cooperatives use 23 different core banking systems. This makes it more expensive to connect with other platforms (e.g., CRM, ERP, collection system). Additionally, only two cooperatives said they use agents. Cooperatives could come together to establish a countrywide network of correspondents to facilitate transactions on their behalf. Actors interested in developing any country's cooperative sector may consider working with cooperatives to collectively achieve economies of scale.

PURSUING DIGITAL TRANSFORMATION

Where should cooperatives start, and what are the fastest routes to market with digital? Based on what we've seen works, BFA Global recommends the following approaches:



Start with 'Why'

The decision to digitize should be driven by a compelling business objective that digital can support. Cooperatives need to make an achievable business case that is based on local market conditions, competition, and customer needs.



Understand your target market(s)

Cooperatives must not skip over the step of deeply understanding the needs and desires of their customers. Both current and potential members should be considered. Potential members represent any customer segment that digital might unlock which the cooperative is not already serving. This process should identify and evaluate the digital needs and capabilities of different customer segments. Some customers will be younger and digitally savvy, and some will be older and less digitally literate. Understanding their financial needs and which ones may be fulfilled digitally is key. Cooperatives should understand current and potential customers' level of experience in the digital world and the digital financial services they may already be using.

Digital customers must have access to digital tools, data connectivity, and digital skills. In Mexico, this is a lower priority pain point given the high penetration of smartphones and availability of public wifi points in parks, convenience stores, and shopping malls. However, cooperatives operating in other markets will need to prioritize studying and addressing these potential barriers.



Understand the regulatory issues

Cooperatives already operate in a highly regulated environment, and the transition to digital will introduce new areas of compliance that require careful consideration. Digital onboarding is one such area. Cooperatives will need to invest in technology that can authenticate new clients' identities electronically. In Mexico, they will need the technical capability to hold and record live online interviews with good image and sound quality. Technical personnel is another compliance area; some laws mandate cooperatives to have specific staff, such as cybersecurity experts. Whether mandatory or not, cooperatives will need staff with specialized knowledge to comply with laws related to critical areas like data privacy and integrity.

Cooperatives may also need to obtain approval for new products and channels prior to roll-out and should take approval timelines into consideration as they plan to digitize. In Mexico, this process can take as long as two years. Cooperatives in Mexico need authorization for any kind of remote operations due to AML regulation, including enrolling new members, accepting certain deposits, and providing some types of loans.

They also need authorization to contract a company outside Mexico for operational purposes and database management. Cooperatives that wait to begin the process of digital transformation risk being overtaken by the competition during long approval processes.



Evaluate your digital readiness

Full digitization will require cooperatives to transform their activities, systems, teams, and processes. Cooperatives should start by understanding the state of the union. Business processes should be reviewed to identify how and where to adjust or reengineer. Core infrastructure should be reviewed (core banking system, data warehouse, reporting, dashboards, integrations) to ensure the architecture is in place to scale. And most importantly, cooperatives must evaluate their own commitment to the process. A shift to a digital mindset will be required organization-wide, from senior management all the way down to front-line staff. It is essential that the board approve a strategy for digital transformation and communicate it to the entire staff effectively.



Start with the core banking system

Members must have access to flexible and convenient digital channels, and this depends on the digital core banking system used by the cooperative. Improving a cooperative's current core or transitioning to a better one is the best first step on the road to digitization. Cooperatives should ensure their digital core has specific characteristics. It must operate without intermittence, be secure, have automated functions, and be able to connect with other platforms, including the CRM, the ERP, and the database, to make real-time queries instead of manual extractions.



Build your digital capacity

Many cooperatives will begin this journey with limited technical skills in-house to execute digital transformation and re-engineer back-end processes. Technical know-how needs to be built and prioritized across the organization, from the top down. In most cases, traditional IT teams are doing the work of digital transformation without the necessary skillsets and product management perspective. Our experience has shown that the most critical set of new skills can be best described as digital product management, or the ability to assess technology-driven solutions and guide their adoption. Cooperatives should have personnel who understand how to implement and manage new products and digital platforms so their adoption and use by the institution and its members are effective. Other core areas of existing expertise within a cooperative – risk management, treasury, and core IT skills – will need to be updated as well.

Recruiting and retaining highly skilled personnel will be a bottleneck. It is difficult for many cooperatives to compete with the salaries product managers and engineers can earn elsewhere, and the dearth of technical talent outside urban areas will be a challenge for rural cooperatives. Some needs can be outsourced through a cloud-based technical partner (although there may be regulatory requirements associated with this), but some skills should be built in-house. A more effective option may be for cooperatives to pool their resources and establish a single digital squad that serves multiple cooperatives, rather than trying to individually hire staff with these capacities.



Transform as you go

Digital transformation can be a long and complex process. It is natural for an institution to feel overwhelmed and uneasy about its ability to fully transform and succeed in a timeframe that can deliver against the competition. However, the process can be broken down into smaller pieces to make consistent and incremental progress.

Cooperatives can set up small MVP development and testing while simultaneously working on the longer-term, full-stack data work. This way, it is possible to put offerings in front of people faster, demonstrating pieces of the value proposition(s) to clients. For example, a cooperative with a core banking system could set up an informational mobile banking site or app which shows the customer their account balance and the general status of their transactions or begin offering transfers between bank accounts. By tackling low-hanging fruit early, a team can create and maintain momentum, deliver some easy wins, and show visible progress.

Phased digitization rollout can give members time to get comfortable and build trust in the new tools. It can also have benefits for the organization: early successes can help to sustain a longer commitment from the organization at large to the overall transformation process.



Use a “Tech & Touch” approach

Since many cooperative members don't have very advanced digital capabilities or are unaware or distrustful of digital financial services, it may be necessary to develop a “Tech & Touch” strategy when launching digital channels and product offerings. Staff at branch offices or other in-person contact

points would help members adopt and use digital tools. They would teach members how to use digital products and services by helping them download apps and showing them how to carry out basic digital operations needed for these offerings. This makes it possible for members who are less comfortable with technology to access digital offerings. To do this successfully, cooperatives must train client-facing staff to assist members efficiently and effectively.



Continuously build and evaluate the business case for digitization

Cooperatives will have to continuously build and evaluate the business case for digitization. Each investment in digital transformation should be evaluated based on its potential ROI. Cooperatives should assess the costs of developing and deploying certain types of technologies and their impacts on the bottom line.



Building and leveraging common resources

Cooperatives may not always be able to meet their needs independently. By joining forces, they can overcome shared hurdles. As described above, cooperatives could address the challenge of finding skilled talent by establishing one team of technical personnel to meet their collective needs. Engaging with or establishing a network of agents is another example: to scale through digital means, cooperatives will need agent outlets to facilitate customers' services and transactions. Rather than every cooperative setting up one-on-one deals with agent networks, a federation or group of cooperatives could establish a single contract with agent networks that each cooperative can plug into. If they scale together, the cooperatives could also potentially secure lower agent fees.

CHALLENGES AND CONCERNS ALONG THE ROAD TO DIGITAL

Digital transformation offers tremendous potential, but cooperatives will have to balance the benefits of digitization with new responsibilities including new partnerships, new capabilities, and new execution risks. Cooperatives are likely to encounter the following challenges during their digital transformation journey:

- ▶▶▶ Constant connection with members can multiply the feedback received, which needs to be processed, responded to and addressed. While this can deliver a superior customer experience, inadequate customer recourse – either through rushed expansion or poorly trained staff and agents – can create confusion and reduce the quality of service.
- ▶▶▶ The shift to digital will require cooperatives to prioritize understanding and executing on the responsible use of data, informed consent, data protection, and security. They will need to plan for hacking, breaches, and business continuity in the case of data loss. Maintaining data privacy is paramount given how easy and low-cost it can be to share or transfer data.
- ▶▶▶ Faster origination, broader outreach, and speed of delivery via digital products and digital channels could lead to more lending, and in some cases too much borrowing. This will require cooperatives to continuously monitor the risk of over-indebtedness.
- ▶▶▶ The low cost, speed of delivery, and scalability of digital communication channels can work wonders in improving customer relationships. However, this can also be leveraged for overly aggressive digital collections and should be monitored closely.
- ▶▶▶ Traditional credit scoring methods can leave out individuals who are not banked. Relying on traditional credit scoring algorithms would exclude large parts of the population, especially lower-income individuals. Cooperatives should consider alternative credit scoring mechanisms and build financial inclusion into the services they are offering digitally, ensuring they can serve low- and middle-income populations adequately. They should also ensure that new algorithms do not generate discriminatory bias.
- ▶▶▶ Collecting digital payments will be difficult for cooperatives operating in cash economies with no or insufficient access to agent networks and digital payment mechanisms. This made loan repayment difficult during the pandemic as some people were unable to physically come to a branch to make a payment and did not have access to agents and digital payment means, as was the case in Mexico.

Current and Future Concerns

The shift to digital carries a variety of misconceptions. Cooperatives should be aware of which of the fears surrounding digitization are myths and which are valid concerns they need to build into their digitization strategies.

Will using digital make loan officers' work redundant?

It is a common fear that smartphone apps and digitized processes could destroy the value judgments of loan officers that are critical for due diligence. On the contrary, digitizing processes frees up time and space for loan officers to make judgments on the most important types of products or parts of the process. The idea of digital transformation is not to eliminate human resources, it is to allow them to specialize. Machines don't understand context or relationships, and humans can and should do the work that machines can't. Cooperatives should be strategic about the tasks they automate versus the tasks they leave to humans to optimize efficiency while maintaining quality.

Will digital lead cooperatives away from their core member base?

Some fear that cooperatives could move away from low-income groups as they digitize. However, this concern underestimates the prevalence of technology. Income is no longer an indicator of how digital you are. Many lower-income populations do have the technology they need to access digital financial services. Those without access to technology are unlikely to be left behind anytime soon. Cooperatives will likely continue using physical branch offices for a long time to come; face-to-face interaction is still a core component of the cooperative model and most cooperatives are in the early stages of digital transformation. It is likely that many members will have access to digital services by the time cooperatives begin reducing their branches.

How will cooperative governance happen in a digital world?

Cooperative members are the owners of the institution and can become elected board officials. How will cooperative board elections happen electronically, and what impacts might this have on decision-making? This is something that will need to be defined down the road as cooperatives digitize further. Cooperatives in Germany and the United States, for example, may have some best practices to share soon.



CONCLUSION

Digital transformation may seem daunting for a sector whose success is based on personal relationships and direct interaction, but the road to digital operations is not new. Banks began to digitize decades ago and had to accelerate the process when the emergence of fintechs disrupted the financial sector. Their mistakes and lessons learned have been studied and well documented. Cooperatives can learn from this precedent to fuel their own success.

Like banks, cooperatives will need to digitize to stay alive in an increasingly competitive environment. Competitors are starting to offer their customers easy digital access, customized products, and 24/7 availability. While cooperatives are aware they must

digitize to compete, they have not done enough. To stay relevant, cooperatives must fast-track their digital transformation. Those who have not begun must start now. They can improve their chances of success and lower costs if they work together and leverage collective capabilities.

There is still time for cooperatives to evolve. By prioritizing innovation, cooperatives can retain and grow their customer base, and remain the primary financial service providers for lower-income populations who benefit from the savings services and low-cost borrowing they offer. With commitment, smart use of resources, and strategic decision-making, cooperatives can take their place in a digital world.



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