

Empresas Públicas de Medellín:

Going Beyond the Basics and
Banking the Unbanked



Empresas Públicas de Medellín and
Opportunities for the Majority
May 2012

PROJECT SUMMARY



**One of the beneficiaries of the EPM
Financiación Social program in the
streets of Medellín, Antioquia.**



Project implementer:

Empresas Públicas de Medellín
(Public Companies of Medellín or EPM),
Medellin - Colombia

Opportunities for the Majority

Loan Amount: US\$10 million

Challenge:

A large part of Colombian adults are unbanked and lack access to credit.

Proposed solution:

Financiación Social (Social Financing or FS), an EPM program, provides accessible credit to those at the base of the pyramid. The program leverages EPM's business platform to assess credit risk by using clients' utilities payment records. After clients are extended a credit line, EPM bills them through their monthly utility bill. With an EPM credit card, customers purchase energy efficient appliances and building materials for home improvements from allied vendors. EPM reports credit performances to credit bureaus, building a credit history for its clients. In 2012, FS will increase credit access to individuals and begin to offer one-time loans to micro and small businesses (a program named MYPES).

About 75% of the population of Medellín, Colombia's second largest city, belongs to the base of the pyramid, and many of them are in search of credit.^{1,2} As of September 2010, 38% of Colombian adults were unbanked and over 80% did not have access to credit.³ In the department of Antioquia, where Medellín is located, only 2.7% of adults have access to credit and 24.4% have access to credit cards.⁴ Those without access to formal credit use alternative mechanisms, such as department store credit cards and *cajas de compensación familiar*, which are private organizations that provide credit and services ranging from education, leisure activities, and housing for its members. However, these credit mechanisms have high interest rates, impose handling fees, or are limited to members. Informal credit lenders may charge interest rates of up to 280% per annum.⁶

The Opportunities for the Majority initiative (OMJ) promotes and finances market-based, sustainable business models that engage private sector companies, local governments, and communities in the development and delivery of quality goods and services for the base of the pyramid (BOP). Created in 2007 as part of the Private Sector Group of the Inter-American Development Bank, OMJ provides loans and partial credit guarantees to medium and large companies and financial institutions to support the development or expansion of business models that serve low-income populations and to share the risk of entering BOP markets. To reach smaller companies and start-ups, OMJ provides credit to impact investing funds. The OMJ portfolio also includes technical assistance grants that are used for business acceleration to assist pre-commercial models to become investment ready; to conduct needed market research; and to build capacity and transfer know-how.

About EPM. Empresas Públicas de Medellín (EPM) is a public utilities company that has been servicing the municipality of Medellín for over fifty years. EPM is the main provider of electricity, water and gas for the department of Antioquia, where Medellín is located. Today, the company provides utilities to well over 2 million customers and is relatively uncontested in the utilities market within the department. EPM provides telecommunications through its subsidiary UNE, also a public company.

This gap in the credit market of Medellín highlighted a strategic opportunity for *Empresas Públicas de Medellín* (Public Companies of Medellín or EPM), an internationally renowned public utilities company, to enter the market. EPM is now financing the unbanked. Since 2008, EPM has implemented a program entitled *Financiación Social* (Social Financing or FS), which aims at providing accessible credit to those at the base of the pyramid. With a loan of US\$10 million provided by Opportunities for the Majority (OMJ), an Inter-American Development Bank initiative, EPM has developed a successful program and committed to its expansion. In the summer of 2012, FS will not only increase credit access to individuals, but also offer one-time loans to micro and small businesses (a program named MYPES) within Medellín's department of Antioquia.

¹ The base of the pyramid (BOP) in Colombia refers to individuals belonging to socioeconomic strata 1, 2, and 3 earning less than 4 minimum wages. As of January 2012 the minimum wage in Colombia was COP\$566,700 (US\$321). The Colombian population is classified based on demographics, income, and other variables as follows: strata 1 (extremely poor), 2 (poor), 3 (low-income), 4 (medium income), 5 (medium-high), or 6 (high).


² Alzate Sánchez, Juan Camilo. Personal Interview. March 27, 2012.

³ Asobancaria.

⁴ Asobancaria.

⁵ Manroth A. & Soto T. (2006). "Access to Financial Services in Colombia: the unbanked in Bogotá," Policy Research Working Paper No. 3834, World Bank.

⁶ USAID/Programa MIDAS. (2007). Encuesta de Mercado de Crédito Informal en Colombia. Retrieved on April 2012 from: http://www.cooperativaemprender.com/uploads/media/Estudio_Credito_Informal.pdf.



EPM envisioned entering the credit market as a means to increase demand for electronics and energy. Under the guidance of former General Director, Federico Restrepo Posada, EPM created a sustainable program that empowers Medellín's lower socio-economic strata building on the company's existing distribution platform. Restrepo had both profits and social impact in mind when EPM created the FS program and introduced the *Tarjeta Grupo EPM*—a credit card with a revolving credit line accessible to its utility clients. With the card, EPM noted that the following benefits existed:

- Increased purchases of energy-efficient appliances with a corresponding increase in use of EPM-provided utilities while helping customers save money.
- Faster and easier access to products serving basic needs such as refrigerators, ovens and gas heaters, which were previously unattainable or expensive and could quickly improve quality of life.
- Creation of a credit history for those without any would open up access to credit lines and loans from other institutions in the future.
- An increase in the rapport between EPM and its customers would continue to benefit the company, which could then generate benefits for the community, creating a virtuous cycle of increased profitability and community investment.



A mother and daughter in an Éxito store, an allied retailer of the FS program, in Medellín.

In developing the structure of FS, EPM faced a number of challenges including:

- How should and could EPM enter the financial sector?
- What purchases and products should EPM credit be directed towards?
- How could EPM differentiate itself from competitors?
- How should EPM assess and mitigate the risk of unbanked card users?
- How could EPM ensure profitability?

As EPM began developing the path to answer these questions, OMJ worked with the company to leverage its business platform by conducting a rigorous set of analyses and assessments to ensure the loan-worthiness of EPM and FS. OMJ assembled a multi-disciplinary team to structure the loan and financial model. This was crucial in building the structure and vision of FS. With the active support of OMJ, the FS team began creating solutions to the aforementioned issues and established a structure for FS centered on reasonable payment schemes and allied business partnerships. Specifically, EPM set out to:

- Build relationships with regulatory entities including fiduciaries and credit bureaus.
- Create alliances with specific vendors, retailers and other businesses.
- Respect the national interest rate ceilings in force for regulated financial institutions and forgo handling fees.
- Establish the appropriate weight for utility payment records on a metrics scorecard to assess and mitigate the risk of potential card users.

This last aspect has a major impact on reducing asymmetry of information. It is pivotal to EPM's ability to differentiate their card from the competition and provide credit to the unbanked. Combining these solutions with OMJ's advice, expertise and involvement, EPM was able to construct a financing program that would yield positive results, both financially and socially. Another benefit of EPM's reach and distribution model is that customers already receive a single bill from the utility company invoicing them for energy, water, and gas use. By adding credit card payments as a line item on the existing monthly bill, EPM minimized the administrative cost of collections and created a payment discipline whereby clients would view making these payments in the same category as paying for basic services.

EPM was able to construct a financing program that would yield positive results, both financially and socially.

The success of *Financiación Social* in its current iteration has encouraged EPM to explore new strategies and expand credit tools. A non-sovereign loan from OMJ, signed in 2011, will allow EPM to further expand the FS program. In mid-2012, EPM will launch a new tool focused on one-time credit loans for micro and small companies (MYPES). These loans will replicate aspects of the *Tarjeta Grupo EPM*, including low interest rates, extended repayment plans, and allied vendors.



Tarjeta Grupo EPM sign-up booths.

Over the course of five months

in 2008, EPM developed the original structure of the financing program with UNE, the company's telecommunication subsidiary.⁷ The EPM team determined the variables with which to evaluate potential card users and envisioned the strategic alliances necessary to develop and implement the program. This included employing a joint fiduciary and creating strategic partnerships with retailers and vendors known as *"aliados"*. Partnerships with department and home improvement stores, such as Éxito and Bodegas Pisende, were created specifically to encourage the purchase of durable goods that would utilize EPM-provided energy, gas, and water or UNE-provided telecommunications. In October 2008, EPM officially launched its pilot program and offered 1,000 *Tarjeta Grupo EPM* cards to utilities customers.

"We are interested in creating opportunities for clients, which is what EPM wants to achieve with their low interest rates".

While the model implemented in 2008 was successful, the *Tarjeta Grupo EPM* was modified in 2011 to increase the importance of utility payment histories for credit scoring. Today, EPM classifies individuals as high, medium, or low risk on the weighted measurement of their last 12 months of utilities payments. Those with low risk are offered the card and those with high risk are rejected. Clients with medium risk are given a *Tarjeta Grupo EPM* card, along with the option to attend workshops that teach individuals about interest rates, revolving credit, and the importance of credit history.



Jorge Sánchez, Regional Manager at Alfagres S.A., a company affiliated to the FS program.

⁷ Including telecommunications in the development was natural since *Tarjeta Grupo EPM* would allow households to purchase telephones and computers that could then access telecommunication services.

Significant *Tarjeta Grupo EPM* details include:

- Clients classified as extremely poor, poor, low-income, and medium income share an annual interest rate of DTF⁸ + 11% points⁹.
- Credit limits are contingent upon an individual's socioeconomic stratum and assessed risk.
- There is no monthly or annual handling fee and payment is fixed on a 48-month term.
- The card may only be used to purchase durable goods which can utilize EPM-provided utilities.
- Payment history is reported to credit bureaus to build credit history.
- Defaulting does not jeopardize a client's access to utilities.

A vital aspect to the success of the FS program is the alliance created with vendors and businesses. Though these partners may differ in their motivations for promoting the *Tarjeta Grupo EPM*, they are mutually dependent on each other for the success of the program.

As EPM expands FS and develops the MYPES credit program, much of the structure of *Tarjeta Grupo EPM* remains. The credit assessment is more focused on the business and not individual credit history. With MYPES, those who have an established micro or small business in good standing with EPM will be able to obtain a one-time loan for the business expansion. Business owners will be offered an interest rate of DTF + 11% points and a repayment period of 60 months. Owners will also have access to workshops that will provide information and skills regarding efficient and sustainable business practices and responsible use of energy.



Stove-tops and water heaters are among the many items a card user can purchase.

⁸. Average 90-day deposit reference rate in Colombia.

⁹. By law the Financial Superintendence sets the maximum annual interest rate allowed. In April 2012 it was set at 30.78%

SHORT-TERM RESULTS

Through the support of OMJ, EPM has been able to leverage its distribution model to offer the unbanked affordable credit lines, impacting their quality of life. The FS team has catalogued numerous stories of individuals purchasing washers, refrigerators, stoves, and other appliances that allow them to save time and money. As Doña Marta Lasalgar, a *Tarjeta Grupo EPM* holder notes, “It is the best credit available with easy and small monthly payments.” Concretely, the FS program has generated the following performance figures:¹⁰

- Over 74,000 cards distributed at the beginning of 2012, over 175,000 projected by 2013 and more than 300,000 by 2016.
- 86% of cards are in active use.
- The average credit limit for each socioeconomic segment of the population is:¹¹
 - Ø Extremely poor → 1,190,223 COP (US\$ 594)
 - Ø Poor → 1,358,216 COP (US\$ 677)
 - Ø Low-income → 1,501,063 COP (US\$ 749)
- As of August 2011, only 2% of card users were 2 months overdue on their payments (cause for suspension of the card).
- The most frequently purchased items by low-income clients are flooring and building materials, small electronics (i.e. irons, blenders) and computers.
- There was an outstanding loan portfolio of US\$ 35.8M as of December 2011.

ANTICIPATED LONG-TERM OUTCOMES

While FS has been a success to date, program implementers continue to look forward. EPM hopes to expand *Tarjeta Grupo EPM* to the outskirts of the surrounding Aburrá Valley, reaching more rural municipalities whose residents have little to no experience using credit cards as a vehicle for payments.

Additionally, EPM has committed to financing established businesses through the MYPES program with the objective of approving 1,000 micro or small business clients in the first six months. EPM anticipates these initial loans will result in 3,000 purchases by business owners. Within five years, EPM expects to have issued nearly 16,000 loans through MYPES, leading to the purchase of over 70,000 items. Between 2012 and 2014, EPM plans on implementing diagnostic analyses of purchases made by

Setting financial and social metrics. In 2011 OMJ adopted the Impact Reporting and Investment Standards (IRIS) taxonomy to effectively capture, track, report, and determine the financial, social, and environmental impacts of its loan and grant portfolios. The IRIS library of standardized social and environmental metrics is used to structure targets for loans and technical cooperation projects, in agreement with OMJ clients. In this way, OMJ can ensure that projects are meeting the organization's goal of developing private sector solutions that foster economic and business growth, and alleviate poverty.

¹⁰ Statistics are accurate as of November 2011, unless otherwise noted.

¹¹ Dollar value calculated using November 30, 2011 exchange rates.

business owners to ensure effective use of the products acquired and efficient use of utilities. EPM anticipates a default rate of no more than 4% for the MYPES program.

EPM and OMJ have jointly established a set of metrics to determine the success of the program, the impact on beneficiaries, and the effective use of OMJ funds. The commitment to measuring and reaching these social and financial goals is agreed as part of the OMJ loan documentation. Besides tracking key operational metrics, such as the number clients per socioeconomic strata, gender, and their use of resources, EPM is measuring the number of clients that access banking services for the first time. These indicators are crucial as they allow OMJ and EPM to understand the needs of their target client base, and whether low-income families are accessing formal credit as a consequence of their participation in the program.

LESSONS LEARNED

Financiación Social has yielded several lessons to EPM and OMJ to date:

- Public utilities companies like EPM are in a unique position to overcome information asymmetries that lead to the financial exclusion or gouging of lower-income people. Clients' payment records are one of the most valuable pieces of information to determine credit profiles.
- The ability to manage risk based on payment history, combined with the ease and low cost of making collections through existing billing mechanisms, allows companies like EPM to offer financing with reasonable interest rates and still be profitable.
- EPM's large base of existing clients, trusted name, and reputation for social commitment allows it to scale the model quickly.
- There is immense potential to replicate the model in other countries like Brazil and Mexico where interest rates on personal loans remain high.

While OMJ's support fortifies internal buy-in for FS, the success of the program is also linked to EPM's commitment to the double bottom line of profits and positive social impact. Combining the vision of EPM with the expertise and resources of OMJ, FS showcases that existing private and public sector delivery platforms can be strategically structured to provide access to credit to the unbanked while generating financial returns.



Group members from FS during a meeting. “The owner of EPM is the municipality. The owner of the municipality is the population, of which the majority is in strata 1-3. The program is set up to be a sustainable program with a social focus.”
—Ana Cristina Rendón Escobar, Manager, EPM Social Financing Program



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