



Enabling financial inclusion in Colombia: Empresas Públicas de Medellín

Summary

Empresas Públicas de Medellín (Public Enterprises of Medellín, EPM) is a utility company offering energy and water services based in Medellín, Colombia's second largest with 2.7 million inhabitants. EPM also has a telecommunications company, grouped under the UNE brand.



estamos ahí.

EPM's clients often have outdated, inefficient home appliances, or lack access to these in the first place – which leads to inefficient use of energy and higher costs. Furthermore, many of the company's clients are excluded from formal credit lines that could enable them access to better appliances. This is in part due to a lack of credit history.

In 2008, the company decided to launch an inclusive business program called *Financiación Social*, aimed at offering microcredit loans to its low-income customers. The offering is based on the unique credit score EPM obtains from clients' payment records on their utility bills. Thereby both interest and default rates have been kept low.

The credits EPM offers are distributed via a series of partner retail stores, and cover the purchase of new appliances or home improvement materials. In addition, EPM provides credits for the purchase of computer equipment through UNE.

Supporting clients to purchase the goods covered under the program makes sense from a social and environmental perspective – as the program enables access to better energy services, saves energy and expenses related to outdated, inefficient equipment, and builds a credit score that allows customers to access other formal sources of credit in the future.

EPM has issued 100,000 cards by autumn 2012, with the goal of expanding the program to 500,000 clients in 2016. In 2012, the program was further expanded to micro and small sized enterprises and could be replicated in other markets like Brazil and Mexico. EPM expects to reach profitability of the project in 2013.

Context

Closing the financial inclusion gap in Colombia

Financial inclusion – access to credit, saving, insurance and payment systems – is a widespread global challenge. Across all continents, billions of people lack the opportunity to deposit their savings in a secure and reliable way, secure themselves against loss of property or health care costs, or to finance much-needed investments to improve their business or their housing situation.

In Colombia, a country of some 45 million inhabitants, only 12% of the population has access to formal credit, while 18% has to rely on family members and friends, who might have only limited resources themselves. Another 6.5 % of the population (three times as much as the Latin American average) relies on informal money lenders, who often charge usurious interest rates.

A series of micro-finance institutions (MFIs) provide credit, mostly to small business owners. They operate branches in low-income communities, and employ mobile agents that visit owners of small shops and businesses. In 2011, the existing banks and microfinance institutions had reached roughly 2.3 million borrowers, disbursing a total amount of credit of some US\$ 5.3 billion.¹

The Colombian government is aware of the vast number of underserved consumers and households that needed credit, for example for house improvements, but do not conform to the evaluation criteria of MFIs. It has made financial inclusion for the low-income segment of the population a priority, providing support and resources through an investment program called “Banca de las Oportunidades”, linking banks, financial service companies, cooperatives, NGOs and pension funds.²

EPM – a local public service company gone global

Empresas Públicas de Medellín (Public Enterprises of Medellín, EPM) is a utility company offering energy and water services based in Medellín, Colombia’s second largest city with 2.7 million inhabitants. EPM was originally active in the electricity, gas, water and telecommunication sectors, and is now a holding company offering these services in a variety of locations. It employs almost 14,000 employees and had revenues amounting to US\$ 6.45 billion in 2011. Over the years, EPM has geographically expanded its activities beyond its home base to encompass all major Colombian cities such as Bogotá, Cali or Bucaramanga as well as foreign markets in Panama, Ecuador, Guatemala, and El Salvador.

EPM aims to universalize service coverage in its markets. It also provides capacity

¹ For further details, see <http://www.mixmarket.org/mfi/country/Colombia>

² Banca de las Oportunidades (2012): Quiénes somos?
<http://www.bancadelasopportunidades.gov.co/contenido/contenido.aspx?catID=298&conID=673>

building workshops for nascent community businesses to take over construction and infrastructure work in the communities it services, contracted by EPM. Fostering income and employment in that way, EPM seeks to create social and economic value in vulnerable communities where it conducts its business.

Business model

While the match between a utility company and the provision of microcredit might not be obvious, it actually made good sense for EPM to set up the *Financiación Social* program in 2008.

Drivers

The overall motivation for EPM to address the low-income segment was a complex mixture of social and financial goals. On the one hand, the project was designed to fulfill the company's mission to provide meaningful services across all customer groups as a utility company, and thus fulfill its corporate social responsibility obligations. On the other hand, EPM tried to develop a financially viable business model that made good business sense.

In searching for a model that would satisfy this double requirement, EPM identified a number of unique advantages that led it to tackle the issue of financial inclusion:

- First, EPM carefully analyzed the situation faced by its low-income clients. Many of them needed credit to improve their housing situation or new appliances, but did not have access to formal sources of credit.
- Second, the company knew that many of these unbanked customers paid their bills with EPM on time, and had thus proven their reliability as debtors. The company decided to leverage its knowledge regarding the payment records of these clients, gaining a unique advantage in credit scoring for customers that so far lived outside of the formal financial system.
- Finally, these customer insights were complemented by existing (business) relationships with the clients – including the delivery of a monthly utility bill and the existence of accessible, affordable payment channels for end-clients. Drawing on such resources, as EPM did, could reduce the startup-time and costs for the endeavor.

Program

When designing the model, the company decided to offer small credits for the purchase of a range of energy-using appliances and construction materials in partner stores.

The program provides loans in two different ways:



- First, the company offers a credit card – called *Tarjeta Grupo EPM* – to its existing utility clients. The card is accepted in several large retailers located in the target area – Éxito, Carrefour, Home Center, Panamericana, and Makro – as well as 73 stores specialized in the goods eligible for financing under the program, and 32 stores offering construction materials.³ Clients can apply for a ‘credit card’, for which they are approved according to a set of criteria – in particular, the requirement to have paid their utility bills regularly and on time.

The goods that are covered under this credit program make sense from the perspective of the company’s core business: While it supplies energy to low-income households, many of these have out-dated, inefficient equipment, or lack appliances such as washing machines, refrigerators or ovens in the first place.



- The second offering is made through EPM’s telecommunication company, UNE.⁴ In its stores, the company provides credit linked to the purchase of computers in a package with Internet connections. Again, the financing of computers responds to an urgent demand of households, while being strongly linked to UNE’s core business of offering telecommunication services.

To distribute the cards and ultimately disburse the credit, EPM established core partnerships with retailers and specialized stores offering housing materials. EPM has leveraged *Financiación Social* to build strong, long-term relations to these allies. Credit installments are included on the electricity or water bill, and collected via the existing methods of in-store payments, bank transfer or deposits at special payment outlets.

Developing, implementing, and refining the model

Financiación Social has had strong support from the company’s leadership from its early days. A “cross-sectional” unit with an interdisciplinary team was created to carry the project forward, develop the model for credit provision and run a first pilot in Medellín. The team also formed relationships with national financial regulators early on in order to align the program with the existing regulation and requirements operating in the finance sector.

³ Grupo EPM (2011): *Financiación Social EPM: Estamos ahí, haciendo de tu hogar un mejor lugar*. Presentation in Washington, DC, on February 15, 2011.

⁴ UNE is the brand used by “UNE EPM Telecomunicaciones S.A.”, the entity under which EPM grouped its telecommunication business in 2006. See <http://www.une.com.co/>

To gain access to additional financing and expertise, EPM teamed up with the “Opportunities for the Majority” program of the Inter-American Development Bank (IDB), which promotes and finances these types of inclusive business projects with loans, guarantees, and technical cooperation.⁵ Of the overall project volume of US\$ 40 million, a quarter was covered through a credit line from the IDB. The partnership was crucial not only from a financing perspective, but also regarding the knowledge exchange in developing and monitoring the model, allowing EPM to draw on the IDB’s varied experiences in the sector.

The program was formally launched in 2008 with the ambitious goal to get 200,000 households into the credit markets by 2015. EPM started from its strong client base in Medellín, which included customers placed in all socio-economic layers.⁶ The model was later expanded to other areas surrounding Medellín.

Over the years, EPM has gathered further experiences with the *Financiación Social* model and has since modified it. The company now classifies customers in three main groups based on their utility payments over the past 12 months, each of which it treats differently in credit disbursement (see Table 1 below).

Table 1: Client classification according to model adaptation in 2011 ⁷

Classification	Result	Optional
High risk	Rejected	–
Medium risk	Accepted	Offered to attend workshops on interest rates, revolving credit and credit history
Low risk	Accepted	–

Results

Jointly with its partner and investor, the abovementioned IDB Opportunity for the Majority team, EPM has developed metrics to capture financial, social and environmental impacts of the program. These metrics are based on the Impact Reporting and Investment Standards (IRIS), which the IDB uses across its loans and technical cooperation projects to ensure that its investments reach the intended goals.

⁵ See <http://www.iadb.org/en/topics/opportunities-for-the-majority>

⁶ Households in Colombia are classified in six “layers”, ranging from 1 (low-income) to 6 (high-income). This classification forms the basis for utility rates and cross-subsidies, but is also commonly used for statistical and planning purposes. For all details, see http://www.dane.gov.co/index.php?option=com_content&view=article&id=354&Itemid=114

⁷ IDB (2012): *Empresas Públicas de Medellín: Going Beyond the Basics and Banking the Unbanked*, IDB: Opportunities for the Majority, Washington, May 2012.

The following sample indicators are tracked by EPM and the IDB:

- The number of clients / purchases per socioeconomic strata
- Gender of clients
- Usage of loans obtained
- Number of clients accessing banking services for the first time
- Financial ratios

The project has yielded encouraging results. In 2010, some 29,000 credit cards were issued and over 23,000 purchases were financed. Most of the credits were used either to buy a computer or to improve the housing situation, e.g. for flooring and panels. The company has surpassed its goals for the third year – both regarding the number of credit cards distributed to clients, as well as the overall amount of credit provided for the purchase of goods.

Since 2010, the number continues to rise: In 2012, 100,000 credit cards were issued up to October. The usage rate of the card is also rising: from 79 percent in 2010 to 86 percent of the utility's clients in 2012. In terms of growth, EPM projects that by 2016 some 500,000 credit cards will be provided.

While the *Financiación Social* program was not primarily started with a financial motivation as a key driver, the company nevertheless aims to achieve financial sustainability. As the project was started “from zero” and required investments in systems, infrastructure and credit disbursement, it was not profitable during the first years. But the current indicators look promising, and the company expects to reach profitability by early 2013.



While access to credit was made available to clients from all six socio-economic strata, it was mainly lower-income clients that made use of this opportunity. Households from the three lowest income brackets accounted for over 90 percent of the purchases financed.

Several indicators and studies suggest that the project indeed has the intended social impact, and benefits EPM's clients in several ways.

- Firstly, credit accessed through EPM is cheaper, sometimes considerably cheaper than accessing credit from informal money lenders, and reduces families' dependency on such informal structures. While EPM charges an average of 17 percent interest rate (without charging additional administrative fees), the going market rates is around 32 percent, plus additional handling fees.⁸

⁸ Source: Interview with EPM

Additionally, the default rate of the program has stayed at a modest 2-3 percent, mainly due to the credit scoring based on the payment track records of customers. This low default rate lowers the cost of credit and indicates that the program's target group is not over-indebted, and finds the means to serve its loan obligations.

- Secondly, the product helps clients to replace their outdated appliances with newer ones conforming to higher standards of energy efficiency. It thus helps the households to reduce their energy consumption and their energy expenditure, as well as reducing its impact on the environment.

Having access to modern appliances not only eases the life of households, but also opens new development opportunities. In 2010, computers were the second-most financed item, also for low-income clients, enabling educational, social and economic opportunities from being able to access a wider range of information sources online. Also, household equipment like fridges or cooking stoves often open new commercial opportunities for households, for example providing catering or food services, or freeing up time currently spent on household duties for more productive uses.

- Lastly, the company helps clients to build a “credit record” by reporting their credit performance to credit bureaus. This makes them less reliant on informal money lenders for future financing requirements, including those that could not be met by EPM's program.

On a more systematic level, a study conducted on the impact of *Financiación Social* concluded that the inclusive business model indeed raised the well-being of the target group, with the corresponding indicator rising from 41.04 to 47.74.⁹

Outlook

By the end of 2012, EPM wants to expand the use of the credit card and aims to reduce defaults and late payments in its regular utility operations. Clients that pay regularly and on time will receive additional benefits – like concert or event tickets. While improving payment morale was not the initial goal of *Financiación Social*, the company has found that the challenge can be tackled via the card-related infrastructure and the relationships with the customers.



⁹ ECSIM (2012), result of consulting project conducted by ECSIM on behalf of EPM, not publicly available.

Additionally, EPM is not only expanding its personal loan program, but also reaches out to new customer groups. In 2012, the company began to finance purchases of micro and small sized enterprises with so-called “productive loans” (*Crédito Crecer*). Similar to the consumer credit program, the credit rating depends on the standing of the enterprise with EPM. Companies are also offered training programs and workshops on the efficient use of energy. For credits of up to US\$ 8,000, entrepreneurs can purchase equipment that helps them raise their productivity.

The goal set for the SME program includes the distribution of credit cards to 1,000 business owners in the first six months, which is expected to result in 3,000 purchases by small businesses.

EPM’s model shows how existing industry structures and customer insights can be combined and utilized in novel ways to provide crucial services to households that were previously excluded. The model can potentially be expanded not only to other areas of Colombia, but also, according to the Inter-American Development Bank, to other countries in the region like Mexico or Brazil, where consumers suffer from being excluded from formal credit markets.

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- Additional information obtained via a telephone interview with Oscar Dario Gomez Hoyos, External Relations Professional, Sustainable Development Department, and Ana Cristina Rendon Escobar, Directo of the Department for Entrepreneurial Projects. The interview took place on October 9, 2012.

Contact

Oscar Dario Gomez Hoyos
External Relations Professional, Sustainable Development Department
Empresas Públicas de Medellín
Oscar.Gomez@epm.com.co