Inclusive Business Case Study: Promigas

Location: Colombia Sector: Utilities and Finance IFC Investment: $155 million in debt financing/$2 million in equity

COMPANY BACKGROUND

Founded in 1974, Promigas is one of the largest and oldest private utility providers of natural gas in Colombia. In addition to its own operations, it has investments in 18 other companies in natural gas transmission and distribution as well as in power distribution in Colombia and Perú. Its customers include power plants, cement, petrochemical, and mining companies as well as residential users. In its home country, Colombia, Promigas through its five distribution companies serves 2.9 million households—approximately 25% of the total population.

Promigas is mainly owned by private investors such as Corficolombiana, Corredores Capital Private Equity, EEB, Amalfi, and Consultoría de Inversiones. Around 8.5% is owned by Colombian pension funds and the remainder is owned by more than 800 minority shareholders. The company has been listed on the Colombian stock exchange since 1989.

PROMIGAS' INCLUSIVE BUSINESS MODEL

Approximately 88% of Promigas' residential customers in Colombia belong to the country's lowest-income strata. The company has connected more than 90% of these customers to the natural gas network for the first time. Because the cost of a new home connection can be as much as three times the monthly income for these families, at approximately US$600 per home, Promigas and its five distributors—Gases de Occidente, Surtigas, Gases del Caribe, Gases de la Guajira, and Efigas—offer financing in order to get over this main barrier to service penetration. The financing is a credit with an implicit interest rate. New customers pay $25 up front, and then spread the remaining amount over several months for up to a maximum of 72 months, paying an additional $10–15 a month on their regular gas bills. Because natural gas costs less than other available energy sources, customers generally recoup their investments in four to six years through energy cost savings.

At various points, donors like the World Bank and Dutch government have provided funds partially subsidizing new home connections for certain low-income groups, but even the subsidized cost has typically exceeded recipients' capacity to pay up front. 98% of users belonging to the country's lowest-income strata have utilized the financing option, with an overall repayment rate of 98%.

As market penetration increased and more and more new customers paid off their connections, Promigas' revenues from that part of the business began to decline, leading the company to undertake a strategic planning process seeking ways to avoid a decrease in EBITDA, create additional value for consumers, differentiate itself from competitors, and connect with the next generation of customers. Promigas realized that with more than 30 years of financing new home connections, it had developed a "hidden asset": knowledge of the payment habits of two million clients, 70% of whom had no other access to the financial system, and did not have credit histories available to other companies. The company was also considered to have a certain "share of wallet" from these clients already—the $10–15 set aside in their monthly budgets to pay off their gas connections, thus keeping their gas service available.

Promigas decided to leverage this asset and retain its "share of wallet" by offering their clients credit for other uses once they had paid off their gas connections. The company conducted a large-scale survey and found that people needed credit for home improvements, starting their own businesses, school fees, household appliances, and emergencies. Home improvements, especially floors, were clients' top priority since 50% of respondents either had plain cement floors in their homes or no floors at all.

After a year-long pilot phase, Promigas launched a new financing product focused on home improvements and appliances in December 2007 under the Brilla name. In 2011, the company included financing for technical and technological education. The single brand name enabled Promigas and its local distribution companies (LDCs) to launch a unified marketing campaign and maximize brand recognition for the new program. Endorsing it using their individual brand names enabled the companies to take advantage of the consumer trust they already had.

Brilla offers loans of the same amounts clients had borrowed for their gas connections, at market interest rates and with repayment periods of up to 60 months. No down payment, co-signer, or collateral is required. The average amount borrowed is $400, with monthly payments of $15–30 incorporated into the borrower's gas bill. To be eligible, a prospective borrower must have two years without missing a single gas payment, be the gas account holder, and be finished repaying the gas hookup. He or she must present an identification card, two gas receipts, a signed contract, promissory note, and a repayment instruction letter. The monthly repayment includes credit life insurance (typically up to $0.50 per person/month premium) to cover the outstanding amount in the event of the borrower's death. When a borrower is over the age of 75, a co-debtor under this age is required.

Promigas and its five LDCs approach Brilla sales in different ways. They all rely heavily on two sales channels: door-to-door (either through contractors or through agents belonging to retailers) and direct point-of-sale transactions. Other channels include fairs, agencies, and call centers. For Brilla as a whole, points of sale account for 30% of transactions, door-to-door for more than 60%, and other channels for a minor share.

Once a borrower is approved, he or she can purchase on credit from any one of the 185 retailers registered with Promigas. These retailers include hardware stores, department stores, and appliance vendors eager to expand their sales into segments that would not have been able to afford their products without credit—and without those retailers having to provide credit themselves.

Promigas obtains capital to lend from its own retained earnings and local commercial bank lending. To manage risk, it relies on accurate assessment up-front, rigorous document control, and a convenient repayment channel—the borrower's existing monthly gas bill. As a safety measure, the company has an account receivable provision model that estimates a provision for delinquency levels in receivables; so far this provision has not been used.

Inclusive Business Case Study: Promigas

Location: Colombia Sector: Utilities and Finance IFC Investment: $155 million in debt financing/$2 million in equity

DRIVERS FOR PROMIGAS' INCLUSIVE BUSINESS MODEL

- Company desire to sustain revenue stream from financing, once new gas connections had been paid off
- Demand for home improvement materials and appliances to improve low-income households' quality of life
- Limited access to financing for such purchases

Approximately 98% of Promigas customers took advantage of the company's financing option to connect their homes to the natural gas network for the first time since they could not afford to pay cash. While it required a lot of working capital, at market interest rates, this financing activity generated a reasonable revenue stream for the company, which complemented its regulated revenues from distributing gas. As more and more customers paid off their gas connections, Promigas' revenues from financing began to fall, and the company began to look for ways to preserve its EBITDA and value by financing other items.

Through the survey conducted, the company found considerable demand for financing to purchase home improvement materials, such as flooring and appliances. Approximately 89%[1] of the Colombian population and 70% of Promigas customers lacked access to financing from the formal financial system, leaving them dependent on informal lenders that charged up to 240% interest per year. This created a market opportunity for Promigas—given its intimate knowledge of its customers' repayment habits—to offer credit at more affordable rates, as allowed by financial authorities.

RESULTS OF PROMIGAS' INCLUSIVE BUSINESS MODEL

- More than one million borrowers have benefited from Brilla credit, 94% of them in low-income segments; 31% of loan proceeds used to make home improvements
- $158.6 million in loans outstanding, with only 1.6% more than 60 days past due
- Net revenues of $40.6 million in 2013, up from $1.5 million in Brilla's first year, and EBITDA of $27.9 million
- Recognized as a winner of the G20 Challenge on Inclusive Business Innovation

To date, Brilla has provided more than one million borrowers with access to home improvement materials, appliances, computers, and capital to start micro-enterprises and pay school fees, thus helping to improve their standards of living. 94% of these borrowers come from low-income segments of the population. The company currently has $158.6 million in loans outstanding, with only 1.6% more than 60 days past due. This compares favorably to 5.40% for the Colombian microfinance sector overall. Brilla generated net revenues of $40.6 million in 2013, up from $1.5 million in the program's first year, and an EBITDA of $27.9 million. Promigas now considers Brilla one of its best businesses, mainly because of its impact on low-income families' living standards but also because—being profitable—it is something the company can sustain over time. Brilla has created a wider economic ripple effect as well, creating 2,000-plus jobs within the Promigas system and among the suppliers and retailers who are part of the program.

Promigas' natural gas business has generated impressive results as well, serving 2.9 million households—12 million people, or approximately 25% of the Colombian population—with a cheaper and more environmentally-friendly cooking fuel. 88% of the company's natural gas customers come from low-income segments. Promigas registered consolidated net revenues of $1 billion in 2013, and a consolidated EBITDA of $281.5 million. Promigas was recognized as a winner of the G20 Challenge on Inclusive Business Innovation at the G20 Leaders Summit in 2012.

IFC'S ROLE AND VALUE-ADD

- Provided $155 million in long-term debt and $2 million in equity (now exited) since 1977
- Structured a $15 million syndication—Promigas was the first Colombian company without a multinational sponsor to access the international long-term loan market after the 1980s debt crisis
- Enabled access to donor funding including a World Bank Output-Based Aid grant to partially subsidize new customers' natural gas connections
- Provided technical support on the environmental aspects of several projects

IFC International Finance Corporation WORLD BANK GROUP

IFC's Investment:

$155 million in debt financing/$2 million in equity

Investment Year:

2009

1 Informe Inclusión Financiera Asobancaria, 2012