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Mobile Financial Services in Microfinance Institutions: Caja Sullana in Peru

Diana Lewin and Martha Casanova

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
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Eidgenössisches Departement für
Wirtschaft, Bildung und Forschung WBF
Staatssekretariat für Wirtschaft SECO

IFC
International Finance Corporation
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Table of Contents

Acknowledgements v

CHAPTER 1: Introduction 1

CHAPTER 2: Overview: Development of mobile financial Services in the Peruvian Market 3

Regulation of Mobile Financial Services 3
Mobile infrastructure 3
Lack of access & unmet demand 4
Caja Sullana: business model and strategy 4
Banking correspondent business model 5
Agent network management 5
Marketing strategies for the BC channel 6
Risk management of the BC channel 6
Performance of banking correspondents: cost and benefit analysis 6
Cost analysis 7
Benefits of the banking correspondent channel 7
Challenges, lessons and recommendations 8
Challenges 8
Lessons learned 9
Recommendations 9

List of Tables

Table 1: Differences between Kasnet and Cajamax agents 4
Table 2: The process of managing agents 5

List of Figures

Figure 1: Volume and value of Cajamax agent transactions 6
Figure 2: Transaction breakdown by type for Cajamax and Kasnet agents, 2012 6

Figure 3: Kasnet/Cajamax cost comparison 7
Figure 4: Sensitivity analysis – transaction costs as transactions, network and investment grow 8
Figure 5: Sensitivity analysis – transaction costs relative to the number of transactions 8
Figure 6: Agent network management – Key components 9

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	Name	Position
1	Ing. David Chávez Varona	Jefe de Medios de Pago, Productos y Servicios Electrónicos
2	Rossana Jiménez Chinga	Gerente Adjunto de Ahorros y Finanzas
3	Lic. Bertha Isabel Fernández Oliva	Gerente de Administración
4	Econ. Luis Alfredo León Castro	Gerente de Ahorros y Finanzas
5	Samy Wilfredo Calle Rentería	Gerente de Créditos
6	Manuel Casana	Jefe de Marketing
7	Maribel M. Preciado Esquiembre	Jefe de Planeamiento, Investigación y Desarrollo
8	Mg. Luis Alberto Lamela Salazar	Gerente de Riesgos
9	Ing. Carlos E. Paz Amaya	Administrador de Base de Datos
10	Carmen Ortiz Castro	Oficina de Atención al Usuario
11	Edgar Berrocal Vargas	Gerente Zonal III B
12	Lic. Adm. Oswaldo Castillo Barreto	Administrador, Oficina Barranca
13	Econ. Rafael Torres Susanibar	Administrador, Agencia Lima
14	Javier Ernesto Garces Angulo	Analista de Riesgo
15	Sheila Silva	Analista de Riesgo
16	Marco Antonio Cruz Zapata	Asistente Servicios Financieros Electrónicos
17	Luis Fernando Palacios Nuñez	Auxiliar Servicios Financieros Electrónicos
18	Evelyn Córdova Vásquez	Auxiliar de Servicios Financieros Electrónicos

CHAPTER 1

Introduction

This report is part of a series of five case studies conducted under the IFC "Business Case for Mobile Financial Service Channels in Microfinance Institutions" project. The purpose is to analyze how MFIs can implement MFS channels to drive profitable growth while extracting lessons helpful to different stakeholders in the microfinance industry, especially in designing better targeted and successful m-banking projects.

The "Caja Municipal de Ahorro y Crédito Sullana" (Caja Sullana Municipal Credit and Savings Bank) started operations in 1986 in the municipality of Sullana, Piura in Peru. As of December 2012, the organization had penetrated 11 out of the country's 1,831 districts through its 70 branches and offices, becoming the fourth largest CMAC[1] by deposit and credit volumes with 205,146 savings and 119,470 credit clients. The bank offers its services through a variety of channels, including branches, banking correspondents, and home-banking among others.

IFC selected a variety of organizations as case study subjects, differing by region and the business model each has implemented. Caja Sullana was chosen because:

- It was the first MFI to launch a banking correspondent channel in Peru.
- It relies on banking correspondent (BC) schemes, one being its outsourced agent network while the other is managed in-house.
- Caja Sullana operates in one of the microfinance sector's most competitive and sophisticated countries.[2]

The Caja Sullana case study was conducted in July 2013. The team relied on secondary research along with visits to the organization to collect and analyze data, and to interview MFI staff, mobile financial service users and agents.

The study concluded that even though not all of the benefits of operating through agent networks can be quantified, they still exceed the costs. It is well understood that setting up and operating a network of agents is very costly; and growing these operations may be challenging. Nevertheless, agent transactions cost much less than branch transactions. This generates significant cost savings for those operating in this way. Furthermore, implementing agent networks enables the bank to reach remote places more cost effectively while expanding service points and increasing liquidity and revenues from additional services offered, such as bill payments. Simultaneously, the risk of holding cash at branches is reduced Finally the channel could become essential in realizing one of the bank's most ambitious social objectives: enhancing financial inclusion in remote areas.

[1] CMAC. Cajas Municipales de Ahorro y Crédito

[2] According to The Economist Intelligence Unit Limited, in 2012, and for the fifth consecutive year, Peru ranked first in the Global Microscope on the Microfinance Business Environment, a result of the country's strongly competitive microfinance sector and sophisticated regulatory environment.

CHAPTER 2

Overview: Development of mobile financial services in the Peruvian market

The Peruvian financial system comprises 67 entities regulated by the Superintendencia de Banca, Seguros y AFP (SBS); among these 42 specifically target the low-income segment. The Peruvian microfinance sector also includes 15 non-regulated, micro-credit non-governmental organizations, plus 19 specialized cooperatives, amounting to a total of 76 entities involved in the microfinance sector.

As of December 2012, there were a total of 4,285,000 microfinance clients in the country, or roughly 14.2 percent of the total population and 19.37 percent of the economically active population.

A wide diversity of products and services is available to microfinance clients. MFIs offer products to corporate clients, medium- small- and micro-businesses, inclusive of consumer loans and mortgages. Savings products include term deposits, recurring deposits, demand deposits and others. Only a few organizations offer micro-insurance products. Some other services offered by MFIs include: remittances, bill payments, foreign exchange, and interbank transfers.

The growth of the Peruvian microfinance industry has been followed by an improvement in financial inclusion over the past five years. This can be attributed to the great number of players in the industry, the generally favorable regulatory framework for microfinance and specific policies issued to improve financial inclusion. Despite this, Peru still lags behind several Latin American countries as regards financial use and access. For example, Brazil has 45.57 offices per 100,000 adults compared to Peru's 17.47; and Uruguay has 486 and Mexico 416 creditors per 1,000 adults, compared to Peru's 278. As of June 2013, there were a total of 22,952 banking correspondents in the country.

REGULATION OF MOBILE FINANCIAL SERVICES

In June 2005 the SBS introduced a regulation allowing financial entities to offer services through banking correspondents. This alteration cleared the way for regulated MFIs to offer credit payments, cash withdrawals, fund transfers, cash deposits in their own or third party accounts, and bill payments as well as the right to open and close basic accounts.[3] Furthermore, a Law for Electronic Money was passed in early 2013, the objective being to regulate the issuance of e-money.

MOBILE INFRASTRUCTURE

As of December 2012, 99.4 percent of the districts in the country had mobile phone service. This compares to only 38.96 percent of districts with a financial services presence (through offices, ATMs or agents).

At present there are three telecom operators in the country, Telefónica Móviles with a 51 percent market share

[3] In 2011, the SBS introduced regulation for simplified savings account processes, named the "basic account". The main objective is to enhance financial inclusion

(brand name Movistar), followed by América Móvil with 43 percent (brand name Claro) and Nextel (6 percent). The advent of number portability at the beginning of 2010 increased the level of competition among players.

LACK OF ACCESS & UNMET DEMAND

Peru has a competitive and sophisticated microfinance industry, although there is still an important gap in terms of financial inclusion: the percentage of the population with an account at a formal financial institution is relatively low (20.5 percent), while only 33.95 percent of districts have a bank branch office, an ATM or a banking correspondent.

CAJA SULLANA: BUSINESS MODEL AND STRATEGY

The "Caja Municipal de Ahorro y Crédito Sullana" (Caja Sullana) started operations in 1986 in the municipality of Sullana, Piura. By December 2012 the organization had extended its reach to 11 out of Peru's 1,831 districts, operating a network of 70 branches and offices—becoming in the process the fourth largest CMAC[4] measured by deposit and credit volumes.

[4] Cajas Municipales de Ahorro y Crédito

TABLE 1: Differences between Kasnet and Cajamax agents

	Kasnet	Cajamax
Operating scheme	Outsourced to Globokas, with Caja Sullana monitoring operations	Owned, in-house network
	Multi-bank	Caja Sullana only
	Provides hardware	Provides hardware
	Recruits new points	Recruits new points
	Provides supplies	Provides supplies
	National network	One-to-one recruitment of new agents
	Caja Sullana pays a commission on transactions plus a connection fee to Globokas	Caja Sullana purchases the point of sale devices, pays a maintenance fee to Hiper (IT partner), and takes care of HR, IT, and marketing costs.
	Globokas pays transaction commissions to Kasnet agents	Caja Sullana pays transaction commissions directly to agents
IT platform	Agent operations are automatically linked to the banks' core systems	
	Agent points of sale are connected through a Globokas switch	The bank registers each Hiper Center POS in the system
	Operations are debited/credited from the client's account with the net result for Globokas netted out and settled at the end of the day	Each operation involves a debit or credit in both the agent's and client's accounts
Type of transactions available	Withdrawal	
	Deposit	
	Credit Payment	
	—	Bill Payment[a]
	—	Transfer to own or third party
	Balance check	—
Number of agents	1,155	89
Amount of tx	144,939 tx	228,411 tx
Volume of tx	$7.8 million	$17.5 million

[a] *As of October 2013, Caja Sullana had agreements with 80 companies for bill payment including 70 schools, 3 water companies and 4 electricity companies.*

Caja Sullana's portfolio has grown steadily from $89 million in December 2007 to $409 million as of December 2012. Over the same period, average loan size increased from $1,568 to $3,424 per loan client.

BANKING CORRESPONDENT BUSINESS MODEL

Caja Sullana began offering its banking correspondent services via its own network, Cajamax. In 2010, the bank established a partnership with Globokas, which operates a multi-bank agent network called "Kasnet", that now also offers its services. The Globokas partnership grew out of the need to increase the number of service points country-wide, without investing in recruitment, training, hardware, or agent management.

The bank now operates through both networks. Since June 2013, Caja Sullana has used 1,244 agents as conduits for its services offering. And in 2012, these banking agents conducted 373,350 transactions for a total volume of $25.3 million/74 million Peruvian nuevo sol.

AGENT NETWORK MANAGEMENT

The Channels Unit was created in 2007 to oversee all electronic channel functions. It presently has more than ten staff.

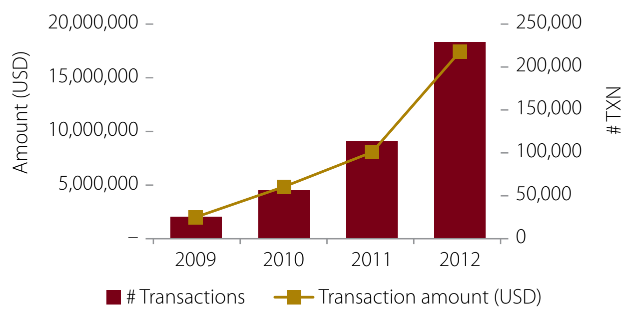
Caja Sullana is supervised by the SBS and must therefore have a Customer Service Unit to assure compliance with the regulations. The Customer Care team responds to client complaints and provides solutions, as well as training, to enable staff to handle products and services, solve client queries and collect and collate feedback on areas needing improvement.

TABLE 2: The process of managing agents

Choosing agent locations and recruitment	Agent training	On-going monitoring	Addressing agent complaints and concerns	Cash management
• The Channels Unit establishes targets regarding new agents based on the strategic business plan and analysis of the past year's performance per channel. • Market potential in the area suggest actual branch location. • It is the branches' responsibility to recruit new agents in their respective operating areas, and align these to channel team criteria. • Agents are shops such as supermarkets, pharmacies, grocery stores and the like. MFI staff have no agent role.	• The Channels team visits the agent location, installs the POS, plus the branding material (banners, flyers, signage), and then trains the agents.	• Agent monitoring is mostly done off-site; and there is no formal process for on-site visits. • On a monthly basis, the Channels team prepares a ranking of best and worst performing agents by branch on a monthly basis. Transactions are then validated for processing commissions and sent to the appropriate branches for completion. • The mother branches inform their agents re: the amount of commissions earned. Then the branch pays the commission to the agent.	• Agents can call Channels team headquarters during office hours regarding complaints and concerns. To resolve day-to-day issues, agents can also liaise with branch staff.	• When recruited, agents must contribute $684–$1,026 of capital. • After three months' operations they qualify for an "Addenda".[a] If approved, the branch is responsible for recovery of the "Addenda" at the end of every month. • Agents can deposit cash at Caja Sullana branches, or make a deposit in favor of Caja Sullana into any bank. • The agent is responsible for security at their shop, and there is no insurance against robberies.

[a] *Revolving credit line from the Bank.*

FIGURE 1: Volume and value of Cajamax agent transactions



MARKETING STRATEGIES FOR THE BC CHANNEL

The marketing unit manages an annual budget for all Caja Sullana products and services. There is no specific budget for the BC channel. Regular materials for below-the-line marketing such as flyers, banners and signage for agents, are covered within this budget.

The bank has found that the most effective marketing strategy is word of mouth (locally known as "mouth to ear"). It has learned that people are most easily convinced to use the service if someone they know recommends it.

RISK MANAGEMENT OF THE BC CHANNEL

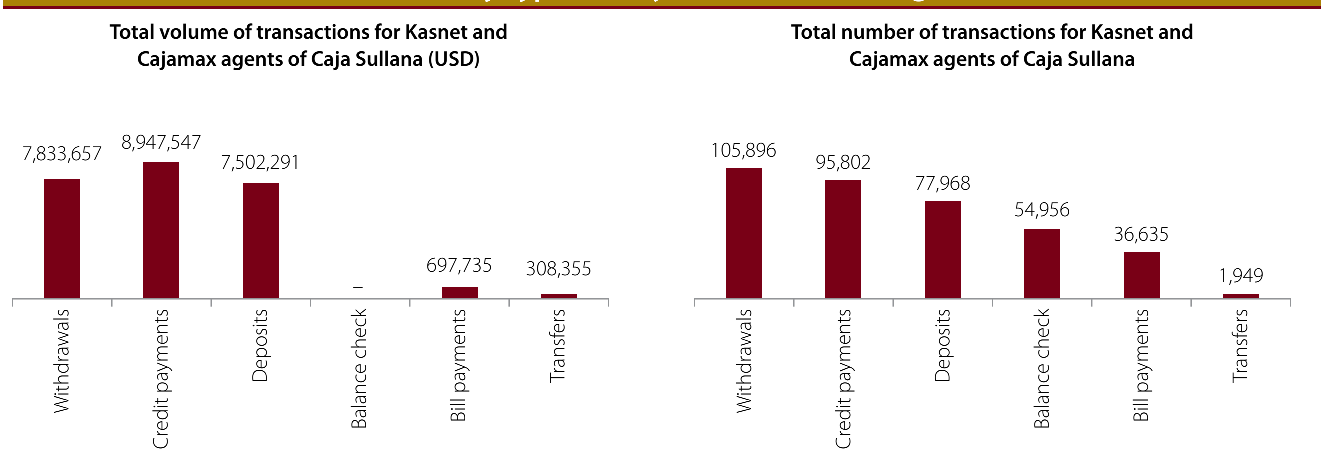
The bank risk management process consists of a thorough evaluation of risk implications, and the introduction of control measures at the earliest stage of a new product or service. All risk events are registered in the bank's risk system, and monitored thereafter.

In terms of compliance with Know Your Customer requirements, agents are not yet allowed to open accounts; therefore only clients who have undergone the regular KYC process can use the service. In withdrawing cash from agents, clients need to present their debit cards. Other transactions, such as making deposits or loan repayments, can be done with client ID or loan numbers. These involve lower risk than withdrawals. However transaction limits are imposed by the regulatory agency to avoid money-laundering issues.

PERFORMANCE OF BANKING CORRESPONDENTS: COST AND BENEFIT ANALYSIS

As can be observed in the figures below, the volume and value of Cajamax agent transactions has been growing steadily, in fact at more than 110 percent per year.

FIGURE 2:Transaction breakdown by type for Cajamax and Kasnet agents, 2012



In December 2012, Cajamax agents conducted an average of 343.13 transactions per month, compared to 26.45 for Kasnet agents. For Cajamax agents, this meant average earnings of $92.76. However, since agent commissions have recently been lowered, Caja Sullana will have to wait and see if the transaction flows and commissions paid remain attractive to these agents.

COST ANALYSIS

The agent channel does not generate any direct revenue for Caja Sullana because transactions do not entail any charges to clients. The only type of transaction that generates revenue is bill payment, which is only available at Cajamax agents. In these cases, Caja Sullana keeps the entire revenue. In 2012, Caja Sullana collected $8,216 for 36,635 bill payment transactions, or average earnings of $0.22 per bill payment. This is lower than the average commission paid per transaction, which stands at $0.23 + VAT.

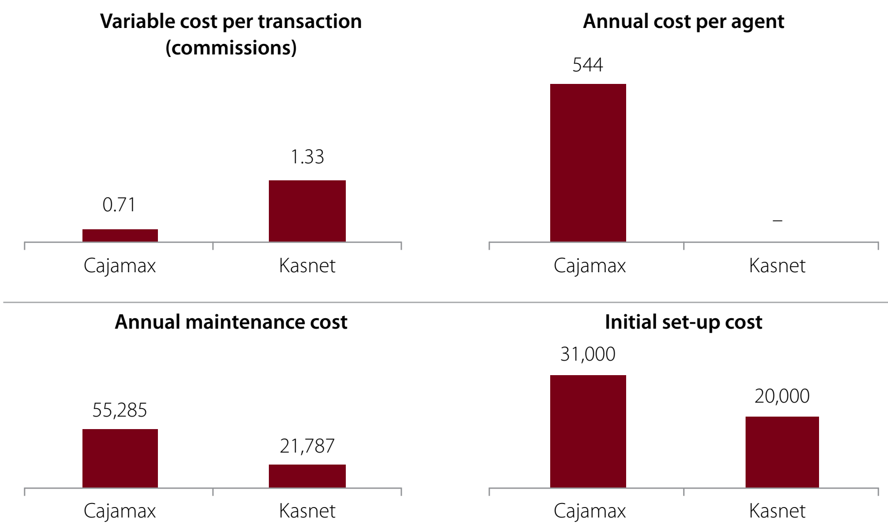
On the other hand, Cajamax agents require a higher initial investment and have higher annual maintenance costs per agent than is the case with Kasnet. However, the variable cost per transaction (commission) is much lower with Cajamax, resulting in total per transaction costs of $0.71 for Cajamax and $1.33 for Kasnet agents.

Deeper analysis of this point underscores that as the number of transactions is markedly increased, transaction costs show a concomitant decrease. Specifically, for example, in doubling the number of transactions (with the needed investment in marketing) would yield a total per unit transaction cost of $0.49 (or 30 percent less than the current cost). Even doubling transactions, agents, marketing and staff needed for network management would lead to a transaction cost reduction (at $0.63 per transaction). Figure 5 details the decrease in transaction costs as the number of transactions increase.

BENEFITS OF THE BANKING CORRESPONDENT CHANNEL

1. ***Increased number of service points in more geographic areas:***
   In introducing the BC channel, the bank was able to add many service points. This contributed to the

FIGURE 3: Kasnet/Cajamax cost comparison



- In the case of Kasnet, 88 percent of the cost is variable, with the remaining and 12 percent fixed.
- For Cajamax transactions, 61 percent of the transaction costs are derived from fixed costs, a much larger contribution than is the case with Kasnet.
- Overall, the variable cost paid per transaction is higher for Kasnet agents than the total cost of Cajamax agents.

Although Kasnet agents provide a great number of additional service points that require negligible investment, the cost incurred per transaction is very high, resulting in 18 percent of the expenses and 43 percent of net losses from all alternative channels.

FIGURE 4: Sensitivity analysis – transaction costs as transactions, network and investment grow

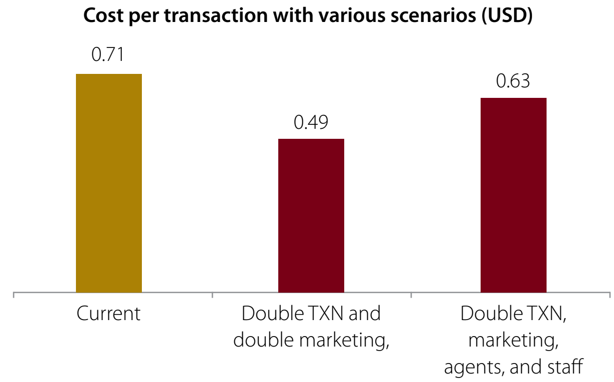
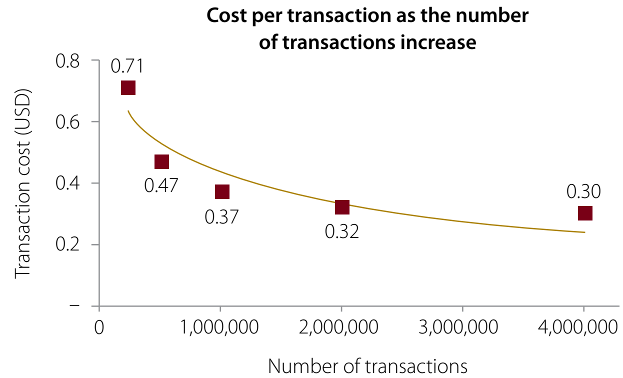


FIGURE 5: Sensitivity analysis – transaction costs relative to the number of transactions



decongestion of branches and improved convenience for clients.

2. ***Reduced cost per transaction:***
Transactions at a branch cashier cost $2.24 USD per tx. By comparison, transactions at Cajamax cost 87 percent less; at Kasnet agents, 43 percent less; and at ATMs, 68 percent less. Considering indirect costs, the channel generated $458,081 of savings, or approximately 5.2 percent of the organization's net profit.
3. ***Increased liquidity and revenue from additional services:***
Bill payment is only possible at Cajamax agents, and this is the only type of agent transaction at that generates direct income for the organization. In 2012, there were 36,635 bill payment transactions which generated $8,216 in direct income along with increased liquidity being made available to the bank.
4. ***Cost savings:***
The channel generated $458,081 of savings, representing an amount equal to 5.2 percent of the organization's net profit.
5. ***New products developed:***
Based on the POS technology of the BC channel, Caja Sullana developed a product called "Prestafácil" with the the aim of reducing moneylender market share in market areas.
6. ***Reduced risk for cash held at branches:***
As the risk is outsourced to agents, management contends that this amounts to effective risk reduction for cash held at branches.
7. ***Technology developed for banking agents can be leveraged in contingency situations:***
When there is a break in the communication systems, Caja Sullana uses the POS devices and the BC network it has developed to conduct branch transactions. Doing so provides great value to the organization, from both the customer service and risk management perspectives.

CHALLENGES, LESSONS AND RECOMMENDATIONS

Challenges

- Growing the Cajamax network: Over the last two years, Caja Sullana has seen high agent turnover. This was mostly due to fraudulent practices among agents, such as transaction fractioning. However, the numbers suggest that the revenue streams to agents are still low. Thus, Caja Sullana must be cautious when decreasing agent commissions because doing so may cause this turnover rate to increase.

- Finding shops suitable to function as agents is not easy.
- Field staff have made a poor contribution in identifying and opening new agent operations.
- The communications infrastructure is not sufficient. The country's Internet/phone coverage is not 100 percent.

Lessons learned

- Clients need to be educated as regards the reliability of agent transactions. This is best achieved by bank staff or through marketing campaigns at branches in which promoters educate clients about the channel.
- Online transactions help to avoid fraud and minimize risks.
- Recruiting existing clients as agents is helpful.
- Developing in-house systems, which is to say independently, facilitates innovation while reducing costs long-term.
- Agent turnover needs to be closely monitored and controlled. Ideally, commissions provide sufficient incentive.Ultimately, however, organizations need to influence agents to identify with the brand; this can be done by having a good support mechanism plus preferential access to products (for example, preferential rates on products).
- Banks can take it for granted that most customers will not trust the channel in the initial stages. Low-income clients tend to respond best to recommendations from a trusted source, such as a bank officer with whom the client has an established relationship, family or friends.

FIGURE 6: Agent network management – Key components

- Pointedly introduce products that drive transaction volumes. Organizations must understand specific market needs in their operational areas to understand what key volume drivers are required.

Recommendations

- Reinforce Caja Sullana client migration as an expedient in increasing the adoption of the new channel.
- Improve the efficiencies (shown in the graphic below) of agent network management in aid of avoiding increased transaction costs, and a decrease in Caja Sullana's outreach due to agent turnover.

Key factors	Recommendation
Monitoring	Automate "transaction splitting".
Agent Support	• Develop more resources to provide agents with better tools for liquidity management • Provide agents with a transaction/earnings report • Provide agents with a local contact to assist them in resolving issues • Conduct detailed analysis to better understand agent turnover drivers; then forge plans to proactively reduce it
Marketing	• Strengthen and invest in agent promotion • Monitor branding of agents
Training	• Provide agents extra training on security issues, particularly how to detect false notes, among other topics • Explore the introduction of a system for on-going and/or refresher training, ideally when new features are introduced • Organize regular agent meetings to provide them an opportunity to learn from other agents and thereby more easily adopt best practices
Increase number of agent transactions	• Add more types of transactions via agents • Make additional marketing efforts to educate clients about the benefits of the agent network • Revise the branch staff incentive scheme to include agent performance (number of transactions) as one of the key performance indicators. This should encourage branch staff to extend further support to agents
Monitoring channel performance	• Monitor key indicators, such as the number of clients and non-clients using the service and transactions per client and non-client • Build an allocation-based costing system that conveys a more realistic picture of channel performance